

February 05, 2024

NMDC Steel Limited: Rating downgraded; continues on Rating Watch with Developing Implications

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Non-Convertible Debenture (NCD) Programme	523.80	523.80	[ICRA]A-; Downgraded from [ICRA]A; continues on rating watch with Developing Implications
Proposed NCD Programme	0.20	0.20	[ICRA]A-; Downgraded from [ICRA]A; continues on rating watch with Developing Implications
Total	524.00	524.00	

*Instrument details are provided in Annexure-I

Rationale

The rating action for NMDC Steel Limited (NSL) factors in the delay in commissioning of the plant and the anticipated elongation of the ramp-up period due to the teething challenges in the steel-melt-shop (SMS) and downstream facilities. The plant was originally expected to be commissioned by end-FY2023, and gradually ramp up the capacity utilisation of finished steelmaking facilities to an average 55% in FY2024. However, the commissioning has been delayed by five months to end-August 2023, and the Q3 FY2024 exit capacity utilisation for the finished steel mill stood at just 24%. As NSL's upstream facilities have ramped up at a faster rate (Q3 FY2024 exit capacity utilisation for the blast furnace and coke oven stood at 45% and 63%, respectively) than the downstream facilities, the company is selling a sizeable share of semi-finished products (like pig iron/pit iron) in the market, which fetch lower realisations. In addition, the output from the finished steelmaking facilities is mainly commodity grade hot rolled (HR) coils at present, realisations of which are at a discounted rate of ~10% to the market rates. Therefore, a suboptimal product mix, coupled with an elevated cost structure due to lower asset sweating and high input costs (especially coking coal), is expected to lead to significantly larger-than-anticipated cash losses in the current fiscal. ICRA expects such cash losses to continue for a large part of the next fiscal as well, albeit some moderation, till the plant's operating rates and efficiency parameters improve and the entire finished product range starts production. In this regard, ICRA understands that intermediation by the original equipment manufacturers (OEMs) in the current quarter is expected to resolve some of the technical bottlenecks in the SMS and downstream facilities, and the pace of ramp-up of these facilities in FY2025 remains an important monitorable from the credit perspective. 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) as a third-party asset operator. While MECON has a long track record in the design and consultancy of steel projects, it has limited experience in managing the operations of large integrated steel plants, exposing NSL to operational and stabilisation risks. Additionally, NSL is susceptible to commercial and marketing risks as the products are yet to be established in the market and customer approvals from OEMs are pending, however, the products as indicated by the management are gaining acceptability in the market supported by quality of the product highlighted through positive customer feedback. ICRA understands that the company is yet to fully establish the dealer-distributor network and is offering products only through the non-trade (auction sales) channel at present where realisations remain less attractive than the trade segment, however, NSL is currently working on marketing aspects which would support the ramp up of sales in the upcoming quarters. NSL is also exposed to the inherent cyclicality of operating in the steel sector, leading to volatility in earnings. ICRA believes that the elevated coking coal costs and sharp correction in steel prices in the current fiscal may accentuate challenges to NSL for achieving the cash break even.

The company also has sizeable annual debt servicing requirements (principal and interest) starting in the current fiscal. However, ICRA notes that the company has adequate liquidity in the form of free cash and bank balance of ~Rs. 700 crore as on December 31, 2023 on top of the undrawn working capital lines and input tax credit of ~Rs. 2,100 crore, which would support the funding requirements till the plant starts generating positive cash flows.

The rating, however, derives comfort from NSL's 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. The plant uses 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, which once stabilised and optimised will provide a competitive edge in the market against its peers. ICRA believes that NSL's energy efficient systems, high level of process automation, captive power generation capacity of 100 MW and competitive grid tariffs would enhance its cost competitiveness once the plant fully ramps up its production and 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. The company would also benefit from its value-added product offerings, that is, special grade steel (utilised by the automotive sector), fetching higher realisations. However, the company is yet to start production from this segment and is yet to approach the OEMs for necessary approvals.

The GoI had announced its decision to divest 50.79% of its stake in NSL and as indicated in the Preliminary Information Memorandum (PIM) for inviting the bids, the remaining 10% equity stake would be offered to NMDC Limited post the divestment. As per the original expected timeline, the divestment was expected to be in advanced stages by the end of FY2024, however, since the original announcement, there have been no developments on the divestment process. This led to uncertainty over the ownership structure and strategic direction for the company in the medium term, which can potentially delay the plant's stabilisation. The rating continues to remain on Watch with Developing Implications owing to the ongoing divestment process. ICRA will closely monitor developments in this regard and finalise its views once more clarity emerges.

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 mirrored the ownership structure of NMDC Limited after the demerger, 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 the divestment process. Additionally, as on September 30, 2023, NMDC has provided non-current interest-free advance of Rs. 2,503 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. Also, NMDC is supporting NSL indirectly through flexibility for the credit terms on iron ore procured by NSL.

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 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. The iron ore will be supplied from NMDC's Bailadila deposit 4, which has an annual mining capacity of 7 million tonnes per annum (mtpa) against the maximum potential requirement of 5 mtpa for NSL, ensuring availability of sufficient raw material for production. 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 over the long term.

State-of-the-art plant with high level of automation, energy efficient systems and captive power generation to support cost competitiveness after operations have been adequately ramped up – 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 through 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 provide significant savings in energy costs as it eliminates the requirement of reheating of slabs before rolling, which is the case in older steel plants. 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 enable 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. However, as on date, NSL has not started production of the special grade steel products and is primarily selling a mix of commodity grade HR coils and pig/pit iron (semi-finished products) at realisations, which are 10% lower than the market rates to get a foothold in its addressable markets.

Credit challenges

Significant delay in ramp-up period over earlier expectations, leading to larger-than-expected losses in FY2024/ FY2025 – The trial run, which was originally expected to commence on March 31, 2023, took place on June 30, 2023 and subsequently the commercial production of the steel plant started on August 31, 2023. As per original expectation, the plant was scheduled to ramp up its operations in FY2024 with an average capacity utilisation of 55%, helping the company achieve cash break even during its first full year of operations. However, due to the delay in the commissioning and teething issues in the SMS unit and the rolling mill, the ramp-up of finished products is much lower than the intermediate products (as reflected in Q3 FY2024 exit capacity utilisation of 24% for the rolling mill against 45% and 63% capacity utilisation of the blast furnace and the coke oven, respectively). Till December 2023, the sale of semi-finished products constituted more than 50% of the monthly sales, pending trial run of the special grade products, however, with the improvement in the production levels and sale of the HR coils from January 2024 onwards the share of the final products is expected to increase in Q4 of FY2024. Therefore, a sub-optimal product mix, coupled with an elevated cost structure due to lower asset sweating and high input costs (especially coking coal) is expected to lead to significantly larger-than-anticipated cash losses in the current fiscal. ICRA expects such cash losses to continue for the large part of the next fiscal as well, albeit some moderation, till the plant's operating rates and efficiency parameters improve and the entire finished product range starts production. In this regard, ICRA understands that intermediation by the OEMs in the current quarter is expected to resolve some of the technical bottlenecks in the SMS and downstream facilities, and the pace of ramp-up of these facilities in FY2025 remains an important monitorable from the credit perspective.

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. As NSL's products are yet to get a foothold in the addressable markets, and customer approvals are pending for the value-added product portfolio, at this juncture, however, the products as indicated by the management are gaining acceptability in the market supported by quality of the product highlighted through positive customer feedback. NSL is dependent on NMDC for supporting the distribution of steel products. Moreover, in the interim period, before NSL is able to set up its dealer-distributor network, the by-products, semis (pig iron and defective steel), and commodity grades of HRC are being exclusively sold through the non-trade route through auctions, which fetch lower realisations than the trade segment, however, NSL is currently working on marketing aspects which would support the ramp up of sales in the upcoming quarters.

Sizeable debt servicing requirements during the initial period of cash burn to increase leverage and weaken liquidity – Funding of the capex worth Rs. 22,223 crore is mainly done through NMDC's treasury with debt sanction of Rs. 5,000 crore. Out of the sanction, debt worth Rs. 4,876 crore (Rs. 523.80 crore of NCD and the balance being term loan) has been drawn down till September 30, 2023 with the availability period of six months from the date of commissioning to draw down the remaining debt, providing an option to draw the debt till February 2024. The repayment tenure for the term loan is 30 quarters, starting March 31, 2024. The company has sizeable annual debt servicing requirements (principal and interest) starting in the current fiscal. While operations will remain loss-making for some time, ICRA notes that the company has adequate liquidity in the form of free cash and bank balance of ~Rs. 700 crore as on December 31, 2023 on top of the undrawn bank lines and input tax credit of ~Rs. 2,100 crore, which would support the fund requirements till the plant starts to generate positive cash flows.

Exposed to operational and stabilisation risks, given the limited track record of NSL and O&M contractor in steel plant operations – The operations and management (O&M) for the first three years are being taken up by Mecon Limited (MECON,) which is a GoI enterprise) as a third-party asset operator. MECON has an established track record in the design and consultancy of large-scale steel projects, however, this is their first O&M project for an integrated steel plant. As MECON has limited 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.

Inherent cyclicity of the steel sector exposes to earnings volatility – The inherent cyclicity in the steel industry exposes steelmakers to a high degree of earnings volatility, which in turn leads to swings in debt protection metrics. Additionally, the deterioration in the operating environment in the current fiscal due to elevated coking coal costs and sliding steel realisations pose additional headwinds for NSL to achieve cash breakeven.

Environment and Social Risks

Environmental considerations: 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 raw material availability.

Social considerations: 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 resettlement and rehabilitation initiatives, the company has employed 750 land losers, which mitigates such risks to an extent.

Liquidity position: Adequate

NSL's operations are expected to remain loss-making in FY2024/ FY2025, and it has sizeable debt service requirements (interest + principal) cumulating to ~Rs. 1,530 crore during this period. However, as on December 31, 2023, NSL's liquidity position remains adequate, supported by free cash and bank balance of ~Rs. 700 crore and input GST credit of Rs. 2,100 crore on capital assets which will be adjusted gradually against output GST received from sale to customers. This gives headroom to tide over any cash flow timing mismatch during the initial period before the operations stabilise and start generating stable cash flows. NSL also has undrawn working capital bank lines of ~Rs. 2,000 crore as on December 31, 2023, providing an additional source of funding during the initial ramp-up phase when the underlying business remains loss-making.

Rating sensitivities

Positive factors – The rating may be upgraded with a timely ramp-up and stabilisation of operations of the steel plant with healthy capacity utilisation rates and operating margins, leading to high free cash flow generation. The rating may also be impacted by the credit profile of the incoming strategic investor.

Negative factors – The rating may be downgraded in case of further significant delay in the ramp-up and inability to stabilise operations, leading to large cash losses for an extended period. The rating may also be impacted by the credit profile of the incoming strategic investor.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Iron & Steel Entities
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 rating is 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 operating a 3.0-metric-tonne-per-annum (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 was commissioned on August 31, 2023. NSL's steel plant can produce 2.9 mtpa of finished steel products like HR coils, sheets and plates. 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)	FY2023	H1 FY2024
Operating income	-	277.4
PAT	-	-131.1
OPBDIT/OI	-	-26.0%
PAT/OI	-	-47.3%
Total outside liabilities/Tangible net worth (times)	0.50	0.6
Total debt/OPBDIT (times)	-	NM
Interest coverage (times)	-	-1.8

Source: Company; Project stage company; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amounts in Rs. crore; NM: Not Meaningful as OPBDIT is only for 1 month

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument	Type	Current rating (FY2024)		Chronology of rating history for the past 3 years			
		Amount Rated (Rs. crore)	Amount Outstanding as of September 30, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021
				Feb 5, 2024	Feb 6, 2023	-	-
NCD	Long Term	523.80	523.80	[ICRA]A- Rating Watch with Developing Implications	[ICRA]A Rating Watch with Developing Implications	-	-
Proposed NCD	Long Term	0.20	-	[ICRA]A- Rating Watch with Developing Implications	[ICRA]A Rating Watch with Developing Implications		

Complexity level of the rated instruments

Instrument	Complexity Indicator
NCD	Very Simple
Proposed NCD	Very Simple ¹

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](#)

¹ 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	8.80% ²	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

² Post the occurrence of the demerger event, the coupon rate have been 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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