June 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]BBB+; downgraded from [ICRA]A-; continues on rating watch with developing implications
Proposed NCD programme	0.20	0.20	[ICRA]BBB+; 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 weaker-than-anticipated performance in FY2024, characterised by significant operating losses of Rs. 1,437 crore during the fiscal. The losses were largely owing to the inventory related losses booked during the fourth quarter of ~Rs. 700 crore in addition to the sub-optimal product mix, an elevated cost structure due to lower asset sweating and high input costs (especially coking coal).

The commissioning of the plant was delayed by five months to August-end 2023, and the FY2024 exit capacity utilisation for the finished steel mill stood at just ~40%. As NSL's upstream facilities have ramped up at a faster rate than the downstream facilities, the company was 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, the realisations of which are at a discounted rate compared to market rates. ICRA expects such cash losses to continue for a large part of the current 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, 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 [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. As on March 31, 2024, NSL had inventory of Rs 3,700 crore (including a significant proportion of finished goods inventory) due to weaker demand in the market leading to increased working capital intensity for the company. To mitigate such risks moving forward, it has been announced that NMDC Limited will act as the distributor for NSL and will manage the selling operations in the external market. Under this mechanism, NMDC Limited will provide the floor price to NSL during the transfer of inventory to their storage units and will share the profit/loss proceeds based on the subsequent external sales of the products in the open market. This would reduce the free up the cash for NSL which would otherwise be tied up in finished goods inventory, thus reducing the working capital intensity/requirements for the operations. NSL is also exposed to the inherent cyclicity of operating in the steel sector, leading to volatility in earnings. ICRA believes that the correction in coking coal prices and recovery in steel realisations in the current fiscal may provide some support to NSL to achieve cash breakeven.

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. 175 crore as on March 31, 2024 on top of the buffer in working capital lines and input tax credit of ~Rs. 2,000 crore, which would support the funding requirements till the plant starts generating positive cash flows. Additionally, the working capital support from

NMDC Limited in the form of finished goods inventory offtake as the distributor will free up some cash for NSL which would otherwise be tied up will provide further cushion to ensure timely debt servicing.

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 the 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 March 31, 2024, 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 and the recent announcement to act as the distributor for 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 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 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 over medium to long term – 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 FY2024 exit capacity utilisation of ~40% for the rolling mill against 51% capacity utilisation of the blast furnace). In FY2024, the sale of semi-finished products constituted significant portion of the sales mix, due to the mismatch in ramp up of the upstream and downstream facilities, however, with the improvement in the production levels and sale of the HR coils from March 2024 onwards the share of the final products is expected to increase meaningfully in FY2025. In terms of operating performance in FY2024, NSL generated a revenue of Rs. 3,049 crore which was lower than our estimates and incurred significant operating losses amounting to Rs. 1,437 crore. The losses were larger than anticipated for the fiscal due to the inventory related losses booked during the fourth quarter of ~Rs. 700 crore in addition to the sub-optimal product mix, an elevated cost structure due to lower asset sweating and high input costs (especially coking coal). 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, the pace of ramp-up of the downstream manufacturing 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; partially mitigated by the proposed support from NMDC Limited to manage the distribution and sales for the company – 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. As on March 31, 2024, NSL had inventory of Rs. 3,700 crore (including a significant proportion of finished goods inventory) due to weaker demand in the market leading to increased working capital intensity for the company. To mitigate such risks moving forward, it has been announced that NMDC Limited will act as the distributor for NSL and will manage the selling operations in the external market. Under this mechanism, NMDC Limited will provide the floor price to NSL during the transfer of inventory to their storage units and will share the profit/loss proceeds based on the subsequent external sales of the products in the open market. This would reduce the free up the cash for NSL which would otherwise be tied up in finished goods inventory, thus reducing the working capital intensity/requirements for the operations.

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 March 31, 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. 175 crore as on March 31, 2024 on top of the undrawn bank lines and input tax credit of ~Rs. 1,500 crore as of May 2024, 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 cyclicality of the steel sector exposes to earnings volatility – The inherent cyclicality in the steel industry exposes steelmakers to a high degree of earnings volatility, which in turn leads to swings in debt protection metrics. However, the improvement in the operating environment in the current fiscal due to correction in coking coal prices and recovering realisations may support NSL's journey 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 liquidity position remains adequate with free cash and bank balance of ~Rs. 175 crore as on March 31, 2024 and undrawn bank lines of ~Rs. 1,500 crore in May 2024, which will give it flexibility to tide over any cash flow timing mismatches during the initial period before the operations stabilise and start generating stable cash flows. NSL has input tax credits of ~Rs. 2,000 crore as GST paid on capital assets as on March 31, 2024. Gradual refund of this amount with collection of GST from sales is also expected to support the liquidity position.

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.

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 change in the linkages of NSL with GoI.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology for Iron & Steel
Parent/Group support	Parent/Group Company: Government of India (GoI) The GoI owns a 60.79% stake of NSL. ICRA also draws comfort from the 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 the 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 to manufacture 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	FY2024
Operating income	-	3,049.0
PAT	-	-1,560.3
OPBDIT/OI	-	-47.1%
PAT/OI	-	-51.2%
Total outside liabilities/Tangible net worth (times)	0.50	0.9
Total debt/OPBDIT (times)	-	-2.7
Interest coverage (times)	-	-4.4

Source: Company; Project stage company; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs. crore; NM: Not Meaningful as OPBDITA 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	Current rating (FY2025)				Chronology of rating history for the past 3 years		
	Type	Amount rated (Rs. crore)	Amount outstanding as on March 31, 2024 (Rs. crore)	Date & rating in FY2025	Date & rating in FY2024	Date & rating in FY2023	Date & Rating in FY2022
				June 5, 2024	Feb 5, 2024	Feb 6, 2023	-
NCD	Long Term	523.80	523.80	[ICRA]BBB+ Rating Watch with Developing Implications	[ICRA]A- Rating Watch with Developing Implications	[ICRA]A Rating Watch with Developing Implications	-
Proposed NCD	Long Term	0.20	-	[ICRA]BBB+ Rating Watch	[ICRA]A- Rating Watch with	[ICRA]A Rating Watch with	-

		with Developing Implications	Developing Implications	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	9.05%[2]	August 28, 2025	523.80	[ICRA]BBB+ Rating Watch with Developing Implications
NA	**Proposed NCD**	-	-	-	0.20	[ICRA]BBB+ 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 has 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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