

October 06, 2023

## Tata Metaliks Limited: Continues on Rating Watch with Developing Implications

### Summary of rating action

| Instrument*               | Previous Rated Amount<br>(Rs. crore) | Current Rated Amount<br>(Rs. crore) | Rating Action                                                     |
|---------------------------|--------------------------------------|-------------------------------------|-------------------------------------------------------------------|
| Fund-based limits         | 230.00                               | 230.00                              | [ICRA]AA; Continues on rating Watch with Developing Implications  |
| Non-fund based facilities | 428.00                               | 428.00                              | [ICRA]A1+; Continues on rating Watch with Developing Implications |
| <b>Total</b>              | <b>658.00</b>                        | <b>658.00</b>                       |                                                                   |

\*Instrument details are provided in Annexure-1

### Rationale

The ratings of Tata Metaliks Limited (TML) continue to remain on Watch with Developing Implications owing to the ongoing merger with Tata Steel Limited (TSL, rated at [ICRA]A1+ and Baa3 (Stable) by Moody's Investors Service), subject to receipt of requisite statutory and regulatory approvals. ICRA will continue to monitor the developments of the merger process and take appropriate action, as may be required, following greater clarity on its implementation timeline.

The ratings factor in TML's healthy financial risk profile, as reflected by its debt free status (excludes lease liabilities) as on March 31, 2023. Although the company's financial performance has been weaker than expected in FY2023 on a YoY basis, with its operating profits contracting by almost 48% due to a sharp correction in pig iron spreads caused by a disproportionate increase in raw material costs (mainly coking coal), the company continued to maintain a strong balance sheet. Despite higher ductile iron pipe (DIP) spreads and higher tonnages, the same did not compensate for the lower earnings from the pig iron segment. Nonetheless, given the company's debt free status, the credit indicators although moderated on a YoY basis, continued to remain healthy. TML's liquidity profile also remains strong, as reflected by the large cash and liquid investment portfolio of ~Rs.203 crore as on March 31, 2023. Notwithstanding the estimated capex plans worth Rs.210-220 crore scheduled for the current fiscal, ICRA expects the company's debt free status to continue. The ratings continue to favourably factor in the integrated nature of TML's business, which reduces the vulnerability of the company's cash flows to fluctuation in input prices. The company has undertaken various process improvement initiatives in the recent past, which have strengthened its operating profile. The ratings continue to be supported by the company's high financial flexibility with established relationships with banks and status as a 60.03% subsidiary of TSL.

While the performance in the first quarter of the current fiscal was adversely impacted by the shutdown of one of its mini blast furnaces, which was undergoing major operational overhaul and repair, ICRA expects the financial performance to improve meaningfully from Q3 of FY2024 as the furnace has become operational again from September 2023. With additional DIP capacities in place, the proportion of hot metal consumed captively is expected to increase, leading to lower sales of pig iron and consequently higher value-added DIP volumes. Higher DIP volumes along with better spreads, as a result of lower raw material prices (mainly coking coal) and attractive DIP tender prices bagged by the company, is expected to lead to a significant improvement in the company's earnings in FY2024. The demand outlook for DIP remains favourable over the medium term, given the Government's focus on ensuring potable drinking water security to every rural household by 2024 under the flagship Jal Jeevan Mission. The Central Government's allocation to this programme has increased by a healthy 27% in FY2024. While some temporary softening in demand may not be ruled out in FY2025 following the General Elections, however, over the medium term, demand for the DIP pipe segment will be supported by the additional government spending on water infrastructure through the Atul Mission for Rejuvenation and Urban Transformation 2.0 (AMRUT) scheme, which has a sizeable outlay and will run through FY2026.

The ratings, however, remain constrained by the exposure of the company to the cyclical nature inherent in the pig-iron business as it remains exposed to the margin risks arising from the temporary mismatch in the prices of raw materials and pig iron, causing volatility in profitability and cash flows. Moreover, the fixed price competitively bid nature of the DIP business keeps the profitability of all DIP players under check, including TML. However, healthy medium-term demand outlook is expected to keep the capacity utilisation of the industry players at a healthy level. The ratings also factor in the changes in the Mines and Minerals (Development and Regulation) Act (MMDR Act), which leads to additional regulatory charges on TML, thus remaining a structural drag on its profits.

## Key rating drivers and their description

### Credit strengths

**Healthy financial risk profile** – Although the company's financial performance has been weaker than expected in FY2023 on a YoY basis, TML's financial profile remained healthy, as reflected by its debt free status (excluding lease liabilities) as on March 31, 2023. The credit indicators, although moderated on a YoY basis, continued to remain healthy with an interest coverage of 5.9 times and TOL/TNW<sup>1</sup> of 0.6 times in FY2023. TML's liquidity profile remains strong, as reflected by the large cash and liquid investment portfolio of ~Rs.203 crore as on March 31, 2023. Notwithstanding the capex plans worth around Rs.210-220 crore scheduled for the current fiscal, ICRA expects the company's debt-free status to continue. This is because the planned capex will be funded through internal sources given the healthy cash generation expected and sizeable liquidity available on the balance sheet.

**Integrated nature of operations partly reduces vulnerability of cash flows to fluctuation in input costs** – The company is one of the largest producers of foundry-grade pig iron in the country with an installed capacity of 6,00,000 metric tonnes per annum (MTPA). A significant portion of the hot metal produced is used in the DIP business, and the balance pig iron, primarily of the foundry grade, is used by the foundry industry to manufacture castings. Over the years, TML has taken various cost improvement initiatives viz. commissioning of a sinter plant in FY2013, and a 10-MW power plant in FY2017, which operates on the flue gas of coke-oven plants (set up under BOOT basis). In January 2019, the company had commissioned a coal injection plant to partially replace coke with pulverised coal, which led to significant cost savings for the company. In February 2021, the company had commissioned another coke-oven capacity (under BOOT basis), which has significantly reduced dependence on external coke. A new power plant (of 15 MW) was also commissioned in March 2021 to further reduce dependence on external power. The integrated nature of TML's operations favourably impacts its cost structure and reduces vulnerability of cash flows to fluctuation in input costs.

**Favourable medium-term demand outlook for DIP in India** – The demand outlook for DIP remains favourable over the medium term, given the Government's focus on ensuring potable drinking water security to every rural household by 2024 under the flagship Jal Jeevan Mission. The Central Government's allocation to this programme has increased by a healthy 27% in FY2024. While some temporary softening in demand may not be ruled out in FY2025 following the General Elections, however, over the medium term, demand for the DIP pipe segment will be supported by the additional government spending on water infrastructure through the Atul Mission for Rejuvenation and Urban Transformation 2.0 (AMRUT) scheme, which has a sizeable outlay and will run through FY2026.

**Status of the company as a part of the Tata Steel Group** – The ratings continue to be supported by the company's high financial flexibility with established relationships with banks and status as a 60.03% subsidiary of TSL. TSL's credit profile has improved significantly in the last two fiscals, as reflected in its reduced balance sheet leverage.

<sup>1</sup> Total Outside Liabilities to Tangible Net Worth

## Credit challenges

**Profit and cash flows exposed to the cyclical nature of pig-iron business** – Raw materials account for the major portion of the operational cost for pig iron players, including TML, and are thus important determinants of profitability. As pig iron business is cyclical in nature, it is exposed to the margin risks arising from temporary mismatch in prices of raw materials and pig iron, causing volatility in profitability and cash flows. The backward as well as forward integration facilities available with the company, however, mitigate such risks to an extent. With the enhanced DIP capacities in place, the volumes of pig iron sold will reduce. Volumes of DIP, which is a value-added product, will increase substantially, leading to lower volatility in cash flows.

**Competitively bid fixed-price orders result in range-bound profitability in the DIP division** – The major portion of DIP's sales takes place through tenders, where the lowest bidder is awarded the contract. This results in significant price-based competition, which keeps the profitability under check. Moreover, a rise in input cost adversely impacts the margins of the DIP business due to the fixed-price nature of the contracts. However, healthy medium-term demand outlook is expected to keep the capacity utilisation of the players at a healthy level.

**Changes in MMDR Act leads to additional regulatory charges; continues to remain a structural drag on profits** – TML procures the major part of its iron ore requirements from the captive mines of TSL. Consequent to the amendment in the MMDR Act effective March 28, 2021, TSL has been recovering an additional 150% of the royalty paid on iron ore fines and 250% of the royalty paid on iron ore lumps sourced by TML. This additional regulatory charge continues to remain a structural drag on the profits of TML.

## Environmental and Social Risks

**Environmental considerations** – Pig iron/DIP manufacturing is an energy intensive process and requires 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 pig iron/DIP manufacturers in the medium term. This in turn leads to a greater focus on reducing the carbon footprint through various technological interventions, like increasing the share of renewables in the energy mix, transition to green hydrogen technologies, decrease in fuel rate in furnaces, and setting up carbon capture utilisation and storage units, to name a few. With many of these emerging low-carbon technologies yet to achieve commercial viability, this transition could entail a significant investment for metal manufacturers. Further, TML faces the risk of physical climate change from floods and drought in the form of disruption in raw material availability due to extreme weather events and impact on water availability due to drought.

**Social considerations** – Social risks for pig iron/DIP manufacturers manifest from health and safety aspects of employees involved in the manufacturing activities. Casualties/ accidents at the operating units due to gaps in safety practices could lead to production outages for pig iron/DIP manufacturers like TML and invite penal actions from regulatory bodies. The sector is exposed to labour related risks and risks of protests/social issues with local communities, which might impact expansion/modernisation plans. Also, the adverse impact of environmental pollution in nearby localities could trigger local criticism.

## Liquidity position: Strong

TML's liquidity profile remains **strong**, as reflected in the large cash and liquid investment portfolio of ~Rs.203 crore as on March 31, 2023. In addition, TML's liquidity profile is supported by the financial flexibility it enjoys for being a strategically important entity of the Tata Steel Group. Notwithstanding the capex plans scheduled for the current fiscal, which will lead to negative free cash flows, ICRA expects the debt-free status to continue as the planned capex will be funded through internal sources, given the healthy cash generation expected and sizeable liquidity available on the balance sheet.

## Rating sensitivities

**Positive factors** – ICRA could upgrade TML's long-term rating if there is an improvement in the credit risk profile of the parent.

**Negative factors** – Pressure on TML’s ratings may arise if there is a deterioration in profitability and cash accruals due to a fall in sales volume emanating from weak demand in end-user industries. Any large debt-funded capex, leading to a sustained deterioration in capital structure and business return indicators, could also result in ratings downgrade. Any deterioration in the credit risk profile of the parent may also put pressure on the ratings. Specific triggers that could lead to ratings downgrade include core RoCE less than 20% on a sustained basis.

## Analytical approach

| Analytical Approach             | Comments                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|---------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Applicable Rating Methodologies | <a href="#">Corporate Credit Rating Methodology</a><br><a href="#">Rating Methodology for Entities in the Ferrous Metals Industry</a>                                                                                                                                                                                                                                                                                                                         |
| Parent/Group Support            | Parent/Group Company: Tata Steel Limited (TSL)<br>ICRA expects TSL to be willing to extend financial support to TML, should there be a need, given its strategic importance to the Tata Steel Group, and out of its need to protect its reputation. Both TML and TSL share the common Tata name, which in ICRA’s opinion, would persuade TSL to provide financial support to TML to protect its reputation from the consequences of a Group entity’s distress |
| Consolidation/Standalone        | For arriving at the ratings, ICRA has analysed TML on a standalone basis                                                                                                                                                                                                                                                                                                                                                                                      |

## About the company

TML was set up as a joint venture (JV) between TSL and West Bengal Industrial Development Corporation (WBIDC) in 1991 to manufacture pig iron. The company had two manufacturing units, one in Kharagpur, West Bengal and the other in Redi, Maharashtra. However, the Redi unit was closed in FY2013 due to sustained losses. TML is a part of the Tata Group of Companies, with TSL owning a 60.03% stake of the company’s equity capital. TML also manufactures DIP at its Kharagpur plant, a forward integration unit of the pig iron business. The DIP business was set up in 2007 in collaboration with Kubota Corporation of Japan (KC) and Metal One Corporation of Japan (MOC). The respective stakes of TML, KC and MOC in the JV stood at 51%, 44% and 5%, respectively. Subsequently, TML increased its stake in the DIP business to 100%, making it a wholly-owned subsidiary. TML merged the wholly-owned subsidiary, Tata Metaliks DI Pipes Limited, with itself, with effect from April 1, 2016.

## Key financial indicators (Audited)

| TML Standalone                                        | FY2022  | FY2023  |
|-------------------------------------------------------|---------|---------|
| Operating Income (Rs. crore)                          | 2,745.5 | 3,259.6 |
| PAT (Rs. crore)                                       | 237.45  | 80.54   |
| OPBDIT/OI (%)                                         | 13.7%   | 6.1%    |
| PAT/OI (%)                                            | 8.6%    | 2.5%    |
| Total Outside Liabilities/Tangible Net Worth (times)  | 0.5     | 0.6     |
| Total Debt/OPBDIT (times) (excluding lease liability) | 0.0     | 0.0     |
| Interest Coverage (times)                             | 14.8    | 5.9     |

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

## 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 Mar 31, 2023 (Rs. crore) | Date & Rating in FY2024                              | Date & Rating in FY2023                              |                                                      |                                                      |                                                                 | Date & Rating in FY2022                              | Date & Rating in FY2021                              |                              |
|   |                           |            |                          |                                                   | Oct 06, 2023                                         | Oct 4, 2022                                          | July 11, 2022                                        | Jun 20, 2022                                         | Apr 29, 2022                                                    | April 8, 2021                                        | Nov 24, 2020                                         | June 29, 2020                |
| 1 | Fund-based limits         | Long Term  | 230.00                   | -                                                 | [ICRA]AA; Rating Watch with Developing Implications  | [ICRA]AA; Rating Watch with Developing Implications  | [ICRA]AA; Rating Watch with Developing Implications  | [ICRA]AA; Rating Watch with Developing Implications  | [ICRA]AA-; Rating Watch with Developing Implications            | [ICRA]AA-; Rating Watch with Developing Implications | [ICRA]AA-; Rating Watch with Developing Implications | [ICRA]AA- (Stable)           |
| 2 | Term Loan                 | Long Term  | 0.00                     | -                                                 | -                                                    | -                                                    | -                                                    | -                                                    | -                                                               | --                                                   | -                                                    | [ICRA]AA- (Stable) Withdrawn |
| 3 | Non-fund based facilities | Short Term | 428.00                   | -                                                 | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+; Rating Watch with Developing Implications            | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+                    |
| 4 | Commercial Paper          | Short Term | 0.00                     | -                                                 | -                                                    | -                                                    | -                                                    | -                                                    | [ICRA]A1+; Rating Watch with Developing Implications; Withdrawn | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+; Rating Watch with Developing Implications | [ICRA]A1+                    |

## Complexity level of the rated instruments

| Instrument                | Complexity Indicator |
|---------------------------|----------------------|
| Fund-based limits         | Simple               |
| Non-fund based facilities | Very simple          |

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](#)

#### Annexure-1: Instrument details

| ISIN | Instrument Name           | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (RS Crore) | Current Rating and Outlook                           |
|------|---------------------------|-----------------------------|-------------|---------------|-------------------------|------------------------------------------------------|
| NA   | Fund-based limits         | NA                          | NA          | NA            | 230.00                  | [ICRA]AA; Rating Watch with Developing Implications  |
| NA   | Non-fund based facilities | NA                          | NA          | NA            | 428.00                  | [ICRA]A1+; Rating Watch with Developing Implications |

Source: Company

#### Annexure-2: List of entities considered for consolidated analysis – Not applicable

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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.

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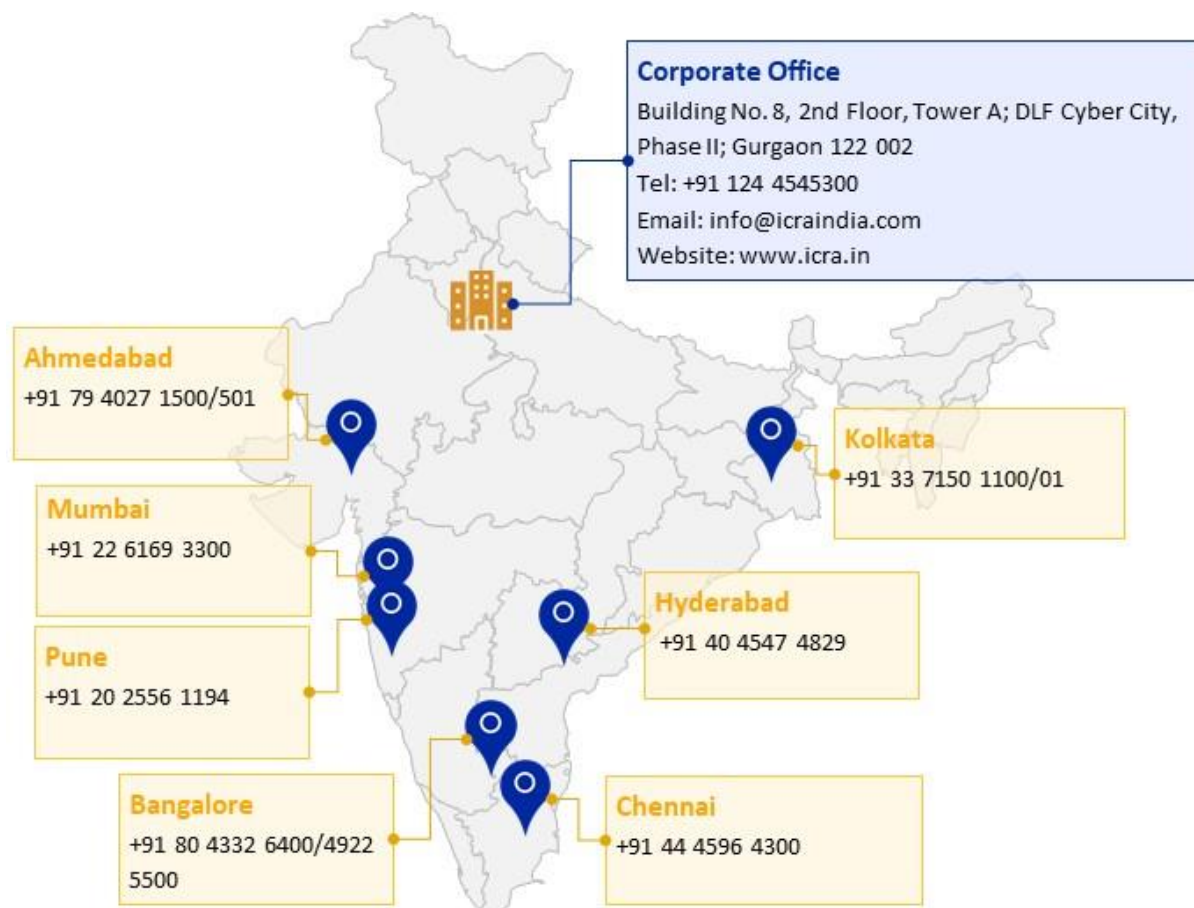


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### Branches



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