February 26, 2021

Tata Steel Long Products Limited: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Commercial Paper Programme	700.00	700.00	[ICRA]A1+ reaffirmed
Total Limits	**700.00**	**700.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of the short-term rating factors in the significant improvement in Tata Steel Long Products Limited's (TSLPL) performance in FY2021, supported by a strong rebound in demand from addressable markets. ICRA notes that after a weak financial performance in FY2020 due to the automobile sector slowdown, TSLPL's credit profile has improved meaningfully in FY2021, as profits surged following the Unlock 1.0, supported by a steep recovery in domestic steel demand. The rating reaffirmation also factors in TSLPL's status as a strategically important entity for Tata Steel Limited (TSL, rated at [ICRA]A1+ and Ba2 (Negative) by Moody's Investors Service), which leads to a high degree of financial flexibility. ICRA expects TSL to be willing to extend financial support to TSLPL, should there be a need, given its strategic importance to the Tata Steel Group, and out of its need to protect its reputation. The rating also reflects the vertically integrated nature of the acquired steel business of TSLPL, supported by captive iron ore mine, and a steady increase in revenue mix from value-added products, both of which are expected to support TSLPL's profit margins going forward. Moreover, TSLPL is expected to benefit from the operational synergies between TSLPL's acquired steel unit in Gamharia and TSL's steelmaking hub in Jamshedpur, given their locational proximity, which could lead to sizeable cost savings derived from operational synergies, as well as the availability of iron ore from TSL's own captive mines.

ICRA notes that on November 13, 2020, the board of directors of TSLPL considered and approved a scheme of amalgamation of Tata Metaliks Limited (TML, rated [ICRA]AA-&/[ICRA]A1+&[1]) and The Indian Steel & Wire Products Limited (ISWPL, rated [ICRA]A&/[ICRA]A1&) into TSLPL, subject to the receipt of requisite statutory and regulatory approvals. Following the proposed merger, ICRA believes that the consolidated entity's credit profile is likely to benefit due to an increase in scale, diversification of products and markets addressed, operational synergies at the upstream and downstream part of the steelmaking value chain, and pooling of cash flows to create an entity with a stronger balance sheet and higher earnings. The short-term rating also factors in the greater visibility towards recovery of TSLPL's invested capital for land and mine infrastructure of the Radhikapur (East) coal block following the recent successful reauctioning of the said block to a new bidder for commercial coal mining.

TSLPL's credit profile, however, also reflects its exposure to sectoral concentration risks, with the automobile sector accounting for a sizeable 50% of the overall sales, thereby exposing the company to earnings cyclicality. TSLPL's rating also incorporates the suboptimal capacity utilisation level of the pellet plant and steel melt shop, and the exposure of the company's earnings to the volatility in steel prices and exchange rate fluctuations. Going forward, TSLPL's ability to sustain its healthy financial performance, seamlessly integrate the operations of the two merger targets, and maintain a comfortable liquidity profile would remain key rating drivers.

[1] &: Rating placed on watch with developing implications

Key rating drivers and their description

Credit strengths

Significant improvement in credit profile in FY2021, supported by a strong rebound in demand from addressable markets - TSLPL's steel business derives strength from its integrated nature of operations. Some of the cost levers associated with integrated operations, like availability of low-cost captive iron ore, as well as optimal asset sweating were not reflected to the full extent in TSLPL's FY2020 financial metrics. The benefit of captive iron ore started to flow in from Q3 FY2020. Moreover, TSLPL's pellet plant started operations in Q4 FY2020, and the benefit was available for only a few months in FY2020. That apart, the company had to manoeuvre through a lull in demand conditions amid the slowdown in the automobile sector in FY2020.

However, backed by the support of its parent, TSLPL embarked on a turnaround strategy of the acquired steel business through a combination of factors which included: a) Higher asset sweating and an increase in market share, b) Product enrichment through increasing share of value-added products by leveraging TSL's techological expertise, c) New customer additions in the 2W and passenger vehicle segments, d) Fixed cost take-outs from operational synergies in marketing and distribution with the parent, e) Variable cost reduction through operational efficiencies in production processes, and f) Savings in raw material procurement costs due to access to Tata Steel's global supply chain. In the current fiscal, with green shoots of recovery seen in TSLPL's key addressable markets, like automobile and tractors, the company bounced back strongly in the green, as witnessed by an operating profit of Rs. 600.6 crore in 9M FY2021 against Rs. 17.2 crore in the corresponding period of FY2020. This has helped the company embark on aggressive deleveraging in the current fiscal, which is expected to result in an improvement in the total debt/ OPBITDA to an estimated 2.1 times in FY2021 from 16.1 times in FY2020.

Status as a subsidiary of TSL with strategic importance as a growth vehicle in the long product segment – TSLPL's status as a 74.91% subsidiary of TSL imparts considerable financial flexibility to the company. TSL has identified TSLPL as the strategic vehicle to focus on the long-products segment, and has provided operational, management and financial support to TSLPL's approximately Rs. 4,668-crore acquisition of UML's steel business. While TSLPL remained a sponge iron and power producer before the acquisition, without any track record of steelmaking, ICRA derives comfort from TSL's long track record of running a large integrated steel business in India. TSL has also committed to provide management support to TSLPL by increasing its involvement in the management as well as board representation of TSLPL. Besides subscribing to 87% of the Rs. 1,485-crore rights issue of TSLPL to partly fund the steel business acquisition from UML, TSL has also expressed its intent of further supporting TSLPL to fund its future growth plans.

Vertically integrated nature of the acquired steel business, supported by captive iron ore mine – TSLPL's around 1-million-tonne-per-annum (mtpa) acquired steel business comprises integrated upstream and downstream facilities such as sinter, pellet, sponge iron kiln, blast furnace, electric arc furnace, wire rod/ bar/bloom mills, captive power plants, and a captive iron ore mine. TSLPL's captive iron ore mine would be able to meet 55-60% of its overall iron ore requirement at the two plants in Jharkhand and Odisha, which partly mitigates the company's profits from a sharp rally in domestic iron ore prices that has been witnessed in FY2021 so far. The vertically integrated nature of TSLPL's operations favourably impacts its cost structure. Moreover, ICRA believes that TSLPL is expected to benefit from the operational synergies between TSLPL's acquired steel unit in Gamharia and TSL's steelmaking hub in Jamshedpur, given their locational proximity, which could lead to sizeable cost savings derived from operational synergies as well as availability of iron ore from TSL's own captive mines.

Increase in revenue mix from value-added products to support profit margins going forward – Following the takeover of the around 1-mtpa alloy steel plant, TSLPL has focused on new product developments and product mix enrichment, which can help increase margins and partly insulate the company's profits from the cyclicality associated with commoditised steel grades. In the last two years, TSLPL has achieved important milestones like addition of 34 new products in FY2020 and 45 in 9M FY2021, and a steady increase in share of alloy steel products to 47% in Q2 FY2021, and 56% in Q3 FY2021 from 35% in Q3 FY2020. An increase in share of more remunerative value-added products strengthens TSLPL's market position and would support its profits margins, going forward.

Proposed merger of TML and ISWPL with TSLPL to strengthen the business risk profile of the consolidated entity – Following the proposed merger of TML and ISWPL with TSLPL, the consolidated entity's credit profile is likely to benefit from an increase in scale, diversification of products and markets addressed, operational synergies at the upstream and downstream part of the steelmaking value chain, and pooling of cash flows to create an entity with a stronger balance sheet and higher earnings. ICRA notes that the merger scheme could take around 6-9 months to get implemented, and that TSL's shareholding in TSLPL would decline to around 69.3% from 74.9% following the merger.

Greater visibility towards recovery of invested capital for the Radhikapur (East) coal block following the successful reauctioning of the block to a new bidder for commercial coal mining – TSLPL has invested Rs. 180.41 crore towards land and surface infrastructure for the 5--mtpa Radhikapur (East) coal block, which was deallocated by the Hon'ble Supreme Court in September 2014. In November 2020, the Ministry of Coal has reauctioned the said coal block, and the same was won by EMIL Mines and Mineral Resources Ltd. The winning bidder would need to pay a compensation of ~Rs. 183 crore towards the land and mine infrastructure to TSLPL. This mitigates the risk associated with the recoverability of TSLPL's investment in the Radhikapur (East) coal block.

Credit challenges

Exposure to sectoral concentration risks – Historically, around 50% of TSLPL's deliveries are directed to the automobile sector, which exposes the company to the sectoral concentration risks. The manifestation of a high exposure to the automobile sector became apparent as the company faced demand headwinds in FY2020, leading to TSLPL reporting a large net loss during the period. ICRA notes that within the automobile sector, TSLPL earlier had a high dependence on the commercial vehicle (CV) segment. However, new customer additions in the 2W and passenger vehicle (PV) sectors in the last two years has aided in partly diversifying its exposure to the highly cyclical CV sector. Moreover, the proposed merger of TML and ISWPL with TSLPL is expected to partly mitigate sectoral concentration risks due to the diversification of the product offering of the consolidated entity.

Suboptimal capacity utilisation levels at the pellet plant and steel melting shop – ICRA notes that TSLPL has not been able to ramp-up to the full rated capacity at the 1.2 mtpa pellet plant and the 1 mtpa electric arc furnace (EAF). It is observed that the peak demonstrated capacity utilisation of the pellet plant is around 50-55%, and that for the EAF is around 70%. Therefore, TSLPL's ability to debottleneck the pellet plant capacity and achieve higher steel production from the EAF unit through arcing would remain key performance drivers, especially in a downcycle year when steel spreads would contract.

Earnings exposed to volatility in steel prices and exchange rate fluctuations – TSLPL's profitability and cash flows are exposed to the cyclicality associated with the steel industry, which keeps margins of all players volatile. TSLPL imports bulk of the coking and non-coking coal requirements from the seaborne market. ICRA notes that high reliance on imported coal exposes TSLPL's profitability to fluctuations in international coal prices as well as fluctuations in the USD-INR exchange rate.

Liquidity position: Strong

Given the challenging operating environment in FY2020 due to the headwinds that the automobile sector was facing, TSLPL reported a negative fund flow from operations of Rs. 100.1 crore during the previous fiscal. However, supported by the V-shaped recovery in demand from the second quarter of the current fiscal, TSLPL's fund flow from operations have swing back in the positive territory. Along with its healthy underlying earnings, TSLPL's tight control on its working capital[2] following the Covid-19 pandemic, would aid it in generating strong cash flow from operations in FY2021. With no major capex lined up at present, TSLPL is expected to generate free cash flows in the range of Rs. 1,000-1,200 crore in FY2021. As on December 31, 2020, TSLPL has a cash and investment balance of over Rs. 800 crore. Therefore, the company's liquidity profile is assessed as Strong.

Rating sensitivities

Negative factors – Pressure on TSLPL's rating could arise if there is a deterioration in the credit profile of TSL, or if TSLPL encounters a sustained period of weak earnings, leading to a significant deterioration of its liquidity profile and credit metrics.

[2] Achieved through a mix of limited credit period to customers, optimal inventory holding period, and extended payment terms with suppliers

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 Company: Tata Steel Limited (TSL) ICRA expects TSL to be willing to extend financial support to TSLPL, should there be a need, given its strategic importance to the Tata Steel Group, and out of its need to protect its reputation. Both TSLPL and TSL also share the common 'Tata Steel' name, which in ICRA's opinion, would persuade TSL to provide financial support to TSLPL to protect its reputation from the consequences of a Group entity's distress.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone[3] financials of TSLPL.

About the company

Tata Steel Long Products Limited (TSLPL) was originally set up as a joint venture between Tata Steel Limited (TSL) and Industrial Promotion & Investment Corporation of Orissa Limited in 1982. At present, TSLPL is a 74.91% subsidiary of TSL. The company is one of the early entrants in the domestic sponge iron industry, with a plant in Keonjhar district of Odisha having an installed capacity of 4,65,000 mtpa. In April 2019, through a slump sale by Usha Martin Limited, TSLPL acquired the former's 1-mtpa integrated alloy steel plant in Jamshedpur. Around 60-65% of TSLPL's sales mix (by value) is accounted from alloy/ high carbon steel sold to the automotive, tractors and other agriculture equipment, lifting & excavation, general engineering, railways, construction (reinforcement), and power (transmission and distribution) sectors.

Key financial indicators (audited)

TSLPL Standalone	FY2019	FY2020	9M FY2021	9M FY2020
Operating Income (Rs. crore)	992.1	3490.0	3203.1	2481.7
PAT (Rs. crore)	124.3	-516.3	231.7	-370.3
OPBDIT/OI (%)	14.8%	4.9%	18.8%	0.7%
PAT/OI (%)	12.5%	-14.8%	7.2%	-14.9%
Total Outside Liabilities/Tangible Net Worth (times)	0.2	2.1	-	-
Total Debt/OPBDIT (times)	0.0	16.1	3.0*	-
Interest Coverage (times)	48.7	0.6	3.2	0.1

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

[3] TSLPL has one wholly owned subsidiary TSIL Energy Limited as on March 31, 2020. TSIL Energy Limited is not a "Material Subsidiary" as defined under the Companies Act, 2013, and is yet to commence its business operations

	Instrument	Current Rating (FY2021)					Chronology of Rating History for the past 3 years							
		Type	Amount Rated (Rs. crore)	Amount Outstanding as of Jan 31, 2021 (Rs. crore)	Date & Rating in		Date & Rating in FY2020		Date & Rating in FY2019			Date & Rating in FY2018	
					Feb 26, 2021	Nov 24, 2020	Jan 13, 2020	Aug 30, 2019	Feb 11, 2019	Dec 24, 2018	Nov 1, 2018	Jan 5, 2018	Aug 3, 2017
1	Fund Based – Cash Credit	Long Term	-	-	-	-	[ICRA]AA- (Stable)* *(Withdrawn)*	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA &	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Non-Fund Based Limits	Short Term	-	-	-	-	[ICRA]A1+* *(Withdrawn)*	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+ &	[ICRA]A1+	[ICRA]A1+
3	Commercial paper programme	Short Term	700.00	0.00	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-	-
4	Fund Based – Proposed Term Loan	Long Term	-	-	-	-	-	-	-	[ICRA]AA- (Stable)* *(Withdrawn)*	[ICRA]AA &	[ICRA]AA (Stable)	[ICRA]AA (Stable)

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 click here

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (RS Crore)	Current Rating and Outlook
NA	Commercial Paper – Undrawn	-	-	-	700.00	[ICRA]A1+

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

TSLPL has one wholly owned subsidiary TSIL Energy Limited as on March 31, 2020. TSIL Energy Limited is not a "Material Subsidiary" as defined under the Companies Act, 2013, and is yet to commence its business operations. Therefore, the standalone financials of TSIL have been considered for assessing its credit profile.

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

Kaushik Das
+91 33 7150 1104
kaushikd@icraindia.com

Ritabrata Ghosh
+91 33 7150 1107
ritabrata.ghosh@icraindia.com

RELATIONSHIP CONTACT

L. Shivakumar
+91 22-61143406
shivakumar@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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.

For more information, visit www.icra.in

ICRA Limited

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches