January 13, 2020

Tata Steel Long Products Limited: Ratings of [ICRA]AA- (Stable)/ [ICRA]A1+ on bank lines reaffirmed and subsequently withdrawn; Short-term rating of [ICRA]A1+ reaffirmed on commercial paper programme

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	70.00	0.00	[ICRA]AA- (Stable) reaffirmed and Withdrawn
Non-fund Based Limits	148.15	0.00	[ICRA]A1+ reaffirmed and Withdrawn
Commercial Paper programme	4,000.00	700.00	[ICRA]A1+ reaffirmed
Total	**4,218.15**	**700.00**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings reflects Tata Steel Long Product Limited's (TSLPL) status as a strategically important subsidiary of Tata Steel Limited (TSL, rated [ICRA]A1+ and Ba2 (Stable) 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 ratings reaffirmation also factors in TSLPL's transition from being a standalone manufacturer of sponge iron (which is a commoditised product), to an integrated alloy steel manufacturer, backed by captive raw material sources[1], which strengthens its business profile. ICRA believes that over the medium term, TSLPL is expected to benefit from the operational synergies between TSLPL's acquired steel unit [erstwhile belonging to Usha Martin Limited (UML)] and TSL's steelmaking hub in Jamshedpur, given their locational proximity, which would not only aid in capacity ramp up, but also lead to sizeable cost savings. The ratings also incorporate the extended ballooning maturity profile of the long-term debt taken to partly fund the inorganic acquisition, which includes a moratorium period till September 2021, supporting TSLPL's liquidity profile.

The ratings are, however, constrained by the prevailing challenging demand scenario for alloy steel manufactures on the back of a marked slowdown in the auto sector, which has depressed TSLPL's realisations, leading to a considerably weaker current year earnings than was envisaged earlier. Along with the high cost of operations in H1 FY2020 due to a greater dependence on costlier external iron ore purchases during the period, TSLPL reported operating losses in the first half of the current fiscal. ICRA notes that the operating profits from the acquired steel business are expected to improve sequentially from H2 FY2020, supported by the bottoming out of realisations in Q3 FY2020, increase in asset sweating, operationalisation of the pellet plant, and multiple cost levers which would manifest in the second half. However, the overall net profitability and debt protection metrics are likely to remain constrained over the near term, given the high capital changes, and limited visibility of a recovery in the commercial vehicle (CV) demand over the near term. The ratings further incorporate TSLPL's exposure to the

[1] TSLPL has a 2.5 million metric tonne per annum (mtpa) operational captive iron ore mine (named Vijay II), and a 0.68 mtpa under-construction captive thermal coal mine (named Brinda-Sasai)

cyclicality associated with the steel sector, forex risks associated with sizeable import of raw materials, and high sectoral concentration risks, given that a large chunk of sales is targeted to the CV industry. Going forward, TSLPL's ability to realise the full earnings potential of the acquired steel asset, before debt servicing starts, would remain a key rating driver.

ICRA has withdrawn the long-term rating of [ICRA]AA- (Stable) and short-term rating of [ICRA]A1+ outstanding on the Rs. 218.15 crore working capital bank lines of TSLPL at the request of the company and following the working capital lenders providing no-objection to ICRA for the rating withdrawal. This is in accordance with ICRA's policy on withdrawal and suspension of credit rating.

Key rating drivers and their description

Credit strengths

Status as a subsidiary of TSL with strategic importance – TSLPL's status as a 75.91% 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 approx. 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 steel making, 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. 1485 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 business, supported by captive iron ore and coal mines – The acquired 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, a captive iron ore mine, and an underdeveloped coal mine. The vertically integrated nature of its operations would favourably impact the cost structure.

Operational synergies with the parent likely to support cost reduction and aid in higher asset sweating – TSLPL's plant is located in proximity to TSL's steelmaking hub in Jamshedpur. ICRA believes that TSL's expertise in running large steel operations, as well as sale of semis/ intermediary products to TSL would aid TSLPL in ramping up of its operations at the acquired plant. In addition, TSLPL is expected to realise sizeable synergy benefits associated with a) savings in raw material procurement costs because of access to TSL's global supply chain as well as availablity of iron ore from TSL's own captive mines, b) fixed cost take-outs from operational synergies in marketing and distribution with the parent, and c) leveraging on TSL's techological expertise to increase the share of value-added products.

Improvement in product profile from sale of commoditised sponge iron to value-added alloy steel products – The inorganic acquisition of UML's 1 mtpa alloy steel plant has strengthened TSLPL's business profile from being a standalone manufacturer of commoditised sponge iron to an integrated alloy steel producer having a high share of value-added long steel products used in automobiles (especially M&HCV), auto ancillary, tractor, railways, general engineering, defence, forging, construction and wire ropes industries.

Elongated maturity profile of acquisition term loan to lower debt repayment burden in initial years – TSLPL has been able to tie-up a long-term debt of Rs. 2,650 crore, having an extended ballooning maturity period of around 11.5 years. This includes a moratorium on principal repayments till September 2021. The company has a comfortable headroom of around 1 year 9 months to fully implement the business turnaround plan, and realise the full revenue potential of the acquired asset before debt servicing starts.

Credit challenges

Demand headwinds amid slowdown in the auto sector leading to a sharp dip in the current year profitability – The domestic alloy steel demand contracted by a sharp 19.4% year-on-year (YoY) in the first nine months (April – December) of the current fiscal thus far, dragged by the downturn that has engulfed the domestic auto sector on account of multiple headwinds which include increase in axle load norms, improvement in fleet turnaround time following GST rollout, and weak consumer sentiment amidst a deceleration in GDP growth. In this backdrop, capacity utilisation rates for TSLPL's finished steel units dropped from 80% in FY2019 to 58% in H1 FY2020.

Exposure to sectoral concentration risks, with the CV industry accounting for bulk of the sales – Around 40-50% of TSLPL's despatches from the Jamshedpur steel unit are used in the manufacturing of CVs, exposing the company to sectoral concentration risks. However, to reduce such risks, TSLPL has initiated discussions with two-wheeler and passenger vehicle OEMs for product approvals. In addition, the company is working on new product developments in value-added categories, which would fetch better realisations.

Debt protection metrics likely to remain depressed in the near term – Weakness in demand led to an 8% decline in TSLPL's blended finished steel realisations in H1 FY2020 over FY2019. Coupled with a higher dependence on costlier external iron ore purchases due to a temporary delay in seeking statutory approvals for starting captive iron ore mining operations, the Jamshedpur steel business reported an operating loss during H1 FY2020. ICRA, however, expects the performance of the acquired steel business to improve sequentially in H2 FY2020, supported by the bottoming out of realisations towards the beginning of Q3 FY2020, a steady increase in asset sweating, and multiple cost levers which would manifest in the second half, which includes a) a decline in coking coal and thermal coal costs, b) full ramp-up of captive iron ore mining operations from October 2019, and c) increase in pulverised coal injection rates following takeover by the new management. Notwithstanding these improvements, given the weak first half performance, total debt/OPBITDA is expected to remain adverse at 16.5 times in FY2020. Though the benefit of lower input costs, as well as the likely operationalisation of the pellet plant in Q4 FY2020 would flow into FY2021 full year earnings, TSLPL's total debt/OPBITDA is expected to still remain subdued at around 5.5 times during the next fiscal, given that a full recovery of the CV industry may take a while.

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: Adequate

TSLPL's liquidity is **adequate**, supported by its sizeable cash and liquid investments of around Rs. 345 crore, and undrawn working capital bank lines of Rs. 270 crore outstanding as on September 30, 2019. In addition, TSLPL's liquidity profile is supported by a moratorium on debt repayments till September 2021, as well as the company's high financial flexibility, as reflected by its ability to raise long-term loans at competitive interest rates.

ICRA notes that despite the significant scale-up of operations in H1 FY2020, TSLPL's operating working capital has increased by a nominal Rs. 70.5 crore between end-March 2019 and end-September 2019, supported by the favourable payment terms with suppliers on account of the company's access to TSL's global supply chain. This leads to a moderate working capital intensity, as reflected by an NWC/OI of 6% in H1 FY2020, which further supports the company's overall liquidity profile.

In FY2020, given the weak earnings from the steel business, a substantial increase in interest burden, and incremental investment in working capital for the acquired steel business, TSLPL's retained cash flows are expected to remain negative. However, in FY2021, supported by the steady ramp-up in operations, resumption of pellet sales, and the benefit of lower raw material costs, TSLPL's retained cash flows are estimated to improve to Rs. 176 crore, which would be adequate to meet the sustenance capex.

Rating sensitivities

Negative triggers – Negative pressure on TSLPL's rating could arise if there is a deterioration in the credit profile of TSL, or if TSLPL is unable to turn around the operations of the acquired steel business before repayment of the acquisition debt starts from September 2021.

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	TSLPL has a wholly-owned subsidiary, TSIL Energy Limited, which is a non-operating entity in which TSLPL has invested Rs. 1.06 crore. As the operations in TSIL Energy Limited are not material in nature, the standalone results have been considered for financial evaluation.

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 75.91% 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. TSIL's sponge iron capacity is 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.

In H1 FY2020, the company reported a net loss of Rs. 270.83 crore on an operating income of Rs. 1,482.38 crore compared to a net profit of Rs. 124.33 crore on an operating income of Rs. 992.05 crore in FY2019.

Key standalone financial indicators

	FY2018	FY2019	H1 FY2020
Operating Income (Rs. crore)	800.52	992.05	1,482.38
PAT (Rs. crore)	140.86	124.33	-270.83
OPBDIT/OI (%)	22.83%	14.84%	-1.19%
RoCE (%)	27.71%	22.67%	-9.08%
Total Outside Liabilities /Tangible Net Worth (times)	0.23	0.22	1.85
Total Debt/OPBDIT (times)	0.00	0.00	-89.33
Interest Coverage (times)	56.29	48.72	-0.12
DSCR (excl. STD/ prepayments)	47.37	42.78	0.05

**Note: Lease liabilities classified as borrowings; Source: Company published results*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2020)					Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating		Date & Rating in FY2019			Date & Rating in FY2018		Date & Rating in FY2017
					13-Jan 2020	30-Aug 2019	11-Feb 2019	24-Dec 2018	01-Nov 2018	05-Jan 2018	03-Aug 2017	20-Jan 2017
1	Fund Based – Cash Credit	Long Term	70.00	0.00	[ICRA]AA- (Stable)* *(Withdrawn)*	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA- (Stable)	[ICRA]AA&	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)
2	Non-Fund Based Limits	Short Term	148.15	98.50^^	[ICRA]A1+* *(Withdrawn)*	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+&	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+
3	Commercial paper programme^	Short Term	700.00	200.00^^^	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	[ICRA]A1+	-	-	-	-
4	Fund Based – Proposed Term Loan	Long Term	0.00	0.00	-	-	-	[ICRA]AA- (Stable)* *(Withdrawn)*	[ICRA]AA&	[ICRA]AA (Stable)	[ICRA]AA (Stable)	[ICRA]AA (Stable)

^^outstanding as on October 31, 2019; ^^^Outstanding as on December 31, 2019; Source: Company, ICRA press releases

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 www.icra.in

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	-	70.00	[ICRA]AA- (Stable)* (Withdrawn)
NA	Non-Fund based limits	NA	NA	Upto 365 days	148.15	[ICRA]A1+* (Withdrawn)
NA	Commercial Paper programme	NA	NA	Upto 365 days	700.00	[ICRA]A1+

Source: Company

Annexure-2: List of entities considered for consolidated analysis

TSLPL has wholly owned subsidiary, TSIL Energy Limited, which is a non-operating entity in which TSLPL has invested Rs. 1.06 crore. As the operations in TSIL Energy Limited are not material in nature, standalone results have been considered for financial evaluation.

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About ICRA Limited:

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