

India Ratings Downgrades JSW Steel and its NCDs to 'IND AA-'; Outlook Negative

05 July 2016: India Ratings and Research (Ind-Ra) has downgraded JSW Steel Limited's (JSWL) Long-Term Issuer Rating to 'IND AA-' from 'IND AA'. The agency has also downgraded the company's INR86.35bn non-convertible debentures (NCDs) to 'IND AA-' from 'IND AA'. The Outlook is Negative.

KEY RATING DRIVERS

Stretched Credit Metrics: The downgrade reflects the deterioration in JSWL's consolidated net leverage (debt/EBITDA) to 6.5x in FY16 from 3.9x in FY15 and the decline in its funds flow from operations interest coverage to 1.8x from 2.3x during the same period. JSWL's consolidated EBITDA fell to INR4,957/ton in FY16 from INR7,783/ton in FY15 following a substantial decline in realisation due to import pressure and predatory pricing. The credit metrics were also affected by the debt-led capital expenditure incurred by the company during FY15-FY16 for capacity enhancement.

Risk of Dilution in Regulatory Support: The Negative Outlook reflects the risk of dilution in the protective measures undertaken by the government which could lead to a fall in JSWL's realisation and further deterioration of its credit profile. GoI in FY16 imposed a minimum import price (MIP) and a 20% safeguard duty on steel products. Post the implementation of MIP, flat product (70% of the JSWL's sales) prices improved by about INR5,000/ton as at end-June 2016.

Gradual Recovery of Margins, but Leverage to Remain High: Ind-Ra believes that better demand for steel in the domestic market and continuation of MIP will lead to a significant increase in JSW's sales volumes along with an increase in the average product realisation. The agency expects consolidated EBITDA to recover to the levels of INR7,500/ton from FY16's INR4,957/ton. Although this will help improve consolidated net leverage below 4.0x for FY17 and below 3.0x thereafter, the credit metrics will remain stretched in terms of leverage.

Pressure on Capacity Utilisation: JSWL increased crude steel capacity by about 3.7mt to 18mt in FY16. The agency however expects the company's capacity utilisation levels to come under pressure due to structural overcapacity. Ind-Ra expects incremental steel capacity to be 10-12mt for FY17 compared to incremental consumption of 4-5mt in FY16. Thus, import substitution is important for the demand-supply equation to remain balanced. Though the import volume has substantially reduced post implementation of MIP, the domestic steel industry may remain vulnerable to imports due to a continuous decline in apparent consumption and capacity overhang in China.

Lack of Raw Material Linkages: JSWL lacks captive linkages for its key raw materials - iron ore and coking coal. The company is exposed to volatility in raw material prices (nearly 60% of its revenue), despite diversifying its procurement sources. JSWL imports its entire coking coal requirement while iron ore is procured from both domestic and international sources. The company intends to improve backward integration through the acquisition of raw material assets.

Strong Business profile: JSWL has one of the lowest conversion costs compared with its peers globally, despite the absence of captive iron ore and coal linkages. This is primarily due to its manpower productivity and state-of-art manufacturing facilities. The company has a dominant market share in southern and western India. JSW's strategic partnership with JFE Steel Corporation (Japan) for technology has also provided a distinctive advantage to it.

Adequate Liquidity: JSWL had free cash and equivalent of INR6.95bn and unused working capital limits of close to INR50bn at end-March 2016. The agency expects JSW's cash flow from operations to remain positive during FY17-FY18. JSWL has planned INR43bn capital expenditure in FY17 of which INR15bn is likely to be funded with debt. Ind-Ra takes comfort from JSW's established standing with investors in both domestic and international markets, providing it a strong capital market access. The company has a debt maturity of INR42bn in FY17. The agency does not expect JSWL to face a refinancing requirement for its debt maturities in FY17.

RATING SENSITIVITIES

Negative: Lower-than-expected sales volume growth or weak product realisation per ton or a substantial increase in debt which can lead to decreased visibility of the consolidated net leverage improving below 4.0x by FYE17 could impact the ratings negatively.

Positive: Consolidated net adjusted leverage being sustained below 3.5x could result in a Stable Outlook.

COMPANY PROFILE

JSWL, a member of the JSW Group and part of the Sajjan Jindal Organization, is an integrated manufacturer of a diverse range of steel products with an export presence in over 100 countries. JSWL is one of the largest producers and exporters of coated flat steel products in India. In FY16, JSW's consolidated revenue, EBITDA, and debt was INR419bn (FY15: INR530bn), INR60.73bn (INR94.02bn) and INR406bn (INR393bn), respectively.

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Applicable criteria, 'Corporate Rating Methodology', dated 4 April 2016, are available at www.indiaratings.co.in/

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