

September 08, 2022

## SM Electronic Technologies Pvt. Ltd.: Ratings upgraded to [ICRA]BBB/ [ICRA]A3+; outlook revised to Stable from Positive

### Summary of rating action

| Instrument*                          | Previous Rated Amount<br>(Rs. crore) | Current Rated Amount<br>(Rs. crore) | Rating Action   |
|--------------------------------------|--------------------------------------|-------------------------------------|---|
| Long-term – Fund based – Cash Credit | 20.00                                | 20.00                               | [ICRA]BBB; upgraded from [ICRA]BBB-; Outlook revised to Stable from Positive                      |
| Long-term – Fund based – Term Loan   | 1.58                                 | 1.58                                | [ICRA]BBB; upgraded from [ICRA]BBB-; Outlook revised to Stable from Positive                      |
| Long-term / Short-term – Untied      | 2.07                                 | 2.07                                | [ICRA]BBB/ [ICRA]A3+; upgraded from [ICRA]BBB-/ [ICRA]A3; Outlook revised to Stable from Positive |
| <b>Total</b>                         | <b>23.65</b>                         | <b>23.65</b>                        |   |

\*Instrument details are provided in Annexure-I

### Rationale

The ratings action for SM Electronic Technologies Pvt. Ltd. (SMET) favourably factors in the company's better-than-expected revenue and earnings growth in FY2022 and Q1 FY2023 due to a significant pick-up in order execution, especially from the fast-growing electric vehicle (EV) and consumer durable segments. ICRA expects the company's healthy revenue growth to continue for the remainder of FY2023, aided by an exponential growth anticipated in the EV segment in the medium term<sup>1</sup> as well as development of products in new segments like medical diagnostics and postal services. Additionally, SMET has raised funds worth ~Rs. 20 crore from Satori Electric<sup>2</sup> through fresh equity for investment of ~20.1% in the company in March 2022. This has reduced SMET's dependence on debt, further strengthening its capitalisation and credit metrics in FY2022. Moreover, given Satori Electric's technical knowhow, this strategic partnership is expected to strengthen SMET's product / service delivery capabilities and could open up new growth avenues, in turn supporting a significant scale-up in turnover over the medium term. In addition, reduction in the working capital intensity on the back of improvement in the working capital management has strengthened the company's liquidity position. ICRA continues to derive comfort from the established track record of SMET's management in developing, trading and distributing a wide range of electronic components for customers spanning across energy, automotive, defence and aerospace, mobility, and industrial segments. The ratings also factor in the company's technical knowhow and domain experience in the electronics component industry, which aids the company in developing new solutions and getting repeat orders from its established clientele.

The ratings, however, remain constrained by the company's moderate scale of operations, which limits its financial flexibility, and makes it more vulnerable during a sustained downturn in the industry. The ratings also consider the elevated competition prevailing in the industry due to limited entry barriers and low capital intensity. Intense competition coupled with low bargaining power with much larger customers limits scope for significant margin improvement. ICRA notes that the company is also exposed to high foreign currency fluctuation risks on account of significant dependence on imports, which remain largely

<sup>1</sup> Source: ICRA Industry Report – Indian Electric Vehicle Industry – Charging up the EV revolution (August 2022)

<sup>2</sup> a Japan-based trading firm specialising in electronic equipment including integrated circuits, semiconductors, and other general electronic parts having a turnover of ~US\$ 1 billion in CY2020

unhedged. Nevertheless, the ability of the company to pass on the rising input costs to its established and reputed customers mitigates this risk to a certain extent.

The Stable outlook on the long-term rating reflects a favourable operating environment, supported by the traction in order inflow from the rapidly growing EV and consumer durable segments, which have the potential to accelerate revenue and earnings growth of the company over the near-to-medium term.

## Key rating drivers and their description

### Credit strengths

**Significant increase in order inflow following greater traction from new segments** – The company has witnessed a surge in order inflow in FY2022 owing to development and supply of novel products such as TFT (thin-film-transistor) LCD cluster display for installation in electric two-wheelers and external EV charger that can be plugged in normal sockets. The products also include Brushless DC Motor (BLDC) drives for ceiling fans, which reduce energy consumption, allow variable speed control and changes in rotational direction of the fans, giving them a compelling use case over conventional ceiling fans. Electric vehicle (EV) penetration across automotive segments is expected to grow exponentially over the next decade, spurred by Government support, enhanced awareness and increasing product launches<sup>3</sup>. With positive demand outlook for the EV sector, SMET's earnings growth prospects from the auto segment remains encouraging over the medium term. Additionally, the company has received a large tender worth ~\$56 million from ATHER Energy in FY2023 for procuring and delivery of imported lithium-ion battery (lithium-ion based) from a Chinese OEM on a commission basis. SMET is currently developing new products such as cancer staging medical instrument using ferrous technology, automated post card/ envelope drop detection equipment. ICRA expects that these recent product developments and collaborations will aid the company to sustain higher growth in revenue in the coming years.

**Strategic partnership with Satori Electric expected to strengthen product / service delivery capabilities** – SMET has drawn up strategic partnership with Satori Electric (a Japan-based trading firm specialising in electronic equipment including integrated circuits, semiconductors, and other general electronic parts having a turnover of ~ \$ 1 billion in CY2020) to give comprehensive offering of various product lines and system solutions for the automotive, industrial and IoT markets. Besides, the partnership is expected to aid the company in strengthening product / service deliveries by leveraging Satori Electric's brand and support for tapping new customers.

**Extensive experience of promoters and management team in the industry** – SMET has been involved in development, trading and distribution of a wide range of electronic components since 1990. The management has over 30 years of experience in this industry. Leveraging on the management's technical knowhow and domain experience, the company has been able to establish its position in the market and cater to the requirements of reputed customers. The promoters have established strong relationship with its electronic component supplier over the years, which gives it easy access to a wide range of components.

**Long association with a large customer base and established relationship with suppliers** – The company has more than 3,000 customers. The revenues are fairly diversified, with the top ten customers contributing ~32% to the total sales in FY2022. Further, SMET's products find application in various industries and cater to customers from different sectors like energy, automotive, defence aerospace, mobility, and industrial segments, partly mitigating the risk of a sharp earnings volatility emanating from lower demand from any particular sector. ICRA also notes that SMET's suppliers are spread across various countries such as China, the US and Japan, and it has been able to establish strong relationships with its suppliers over the years.

**Conservative capital structure and healthy coverage indicators** – The company has low dependence on debt given the low capital intensity and a modest working capital cycle, as reflected in a comfortable gearing of 0.2 times as on March 31, 2022.

<sup>3</sup> Source: ICRA Industry Report – Indian Electric Vehicle Industry – Charging up the EV revolution (August 2022)

The coverage indicators remained healthy in FY2022, as indicated by an interest coverage of 19.6 times, NCA/Total debt of 60.1%, and Total Debt / OPBDITA of 0.6 times. SMET has raised funds worth ~Rs. 20 crore from Satori Electric through fresh equity for investment of ~20.1% in the company in March 2022. This has strengthened SMET's capitalisation and credit metrics in FY2022.

### Credit challenges

**Moderate scale of operations making the company vulnerable to sustained industry downturn** – Despite almost a two-fold increase in the operating income (OI) in FY2022 against FY2021, the scale of operations remained moderate with an OI of Rs. 231.67 crore and a net worth of Rs. 57.18 crore in FY2022. In Q1 FY2023, the company has recorded revenues of ~Rs. 130.96 crore (YoY growth of ~126%) and expects to sustain a healthy top line growth, going forward, backed by a strong order pipeline from its established clientele. That said, the company's scale of operations would continue to remain modest, which limits its financial flexibility and makes it more vulnerable during a sustained industry downturn.

**Stiff competition in the industry from several large players and other traders** – The company operates in an intensely competitive industry, characterised by the presence of many multinational corporations like Avenet Inc., Arrow Electronics and other small-scale distributors and traders. Stiff competition restricts pricing flexibility and bargaining power with customers, constraining its profit margins.

**Exposed to foreign exchange fluctuation risks owing to high proportion of import** – The company is exposed to foreign currency fluctuations as ~80-90% of the products are imported. However, the company's practice of marking up its quoted contract prices by ~3% helps in partly compensating for any adverse movement in foreign currency fluctuations. Besides, foreign exchange fluctuation gains of ~Rs. 1.15 crore and ~Rs. 0.04 crore in FY2022 and Q1 FY2023, respectively demonstrate the company's ability to mitigate forex risks even during adverse foreign currency fluctuation in the recent past.

### Liquidity position: Adequate

Healthy fund flow from operations, moderate working capital requirements, and limited capex requirement of the business resulted in adequate liquidity position for the company. The average utilisation of cash credit facilities during July 2021 to July 2022 stood at 26% of the sanctioned limits. This apart, the company maintained a sizeable unencumbered cash balance of Rs. 21.27 crore as on March 31, 2022 on the back of infusion of funds through equity of ~Rs. 20 crore by Satori Electric Co. Ltd., further supporting its liquidity position. In addition, SMET has minimal external debt loan repayment obligations of ~Rs. 0.4 crore per annum in FY2023 and FY2024, which are expected to be serviced from internal accruals.

### Rating sensitivities

**Positive factors** – The ratings may be upgraded if there is a healthy growth in revenues and profits on a sustained basis while maintaining its credit metrics at comfortable levels.

**Negative factors** – The ratings could be downgraded if there is sharp decline in revenues along with a significant decline in profitability. The ratings could also be downgraded if there is any large debt-funded capex, leading to a deterioration in credit metrics or an elongation in the working capital cycle, weakening the liquidity position. Specific metric that could lead to ratings downgrade include Total Outside Liabilities/Tangible Net Worth of greater than 1.5 times on a sustained basis.

### Analytical approach

| Analytical Approach             | Comments  |
|---------------------------------|---|
| Applicable rating methodologies | <a href="#">Corporate Credit Rating Methodology</a> |
| Parent/Group support            | Not Applicable                                      |
| Consolidation/Standalone        | Standalone financial statement of the issuer        |

## About the company

SMET was started by Mr. Manjunath in 1990 as a partnership firm and was converted into a private limited in 2004. It is involved in trading, distribution and supply chain management of a wide range of electronic components such as active components, passive components, radio frequency (RF)/ microwave components, displays, radio frequency identification (RFID) tags and readers, connectors, Wi-Fi and Bluetooth components. In addition, the company offers designing solutions for electronic components and has designed over 50 ready solutions. The ready solutions aid in bringing additional component orders, supporting the revenues of the components trading and distribution business. At present, it has seven branches across India in Bangalore, New Delhi, Pune, Chennai, Hyderabad, Ahmedabad and Mumbai. SMET has association with over 50 foreign suppliers of electronic components including Renesas, Tianma, Fujitsu, Seiko, Epson, Rohm Semiconductor etc.

## Key financial indicators

| LTHL Consolidated                                    | FY2021 (Audited) | FY2022 (Provisional) | Q1 FY2023 (Provisional) |
|--|------------------|----------------------|-------------------------|
| Operating income                                     | 127.7            | 231.7                | 131.0                   |
| PAT  | 5.4              | 10.1                 | -                       |
| OPBDIT/OI  | 6.5%             | 6.9%                 | -                       |
| PAT/OI   | 4.2%             | 4.4%                 | -                       |
| Total outside liabilities/Tangible net worth (times) | 1.1              | 0.9                  | -                       |
| Total debt/OPBDIT (times)                            | 0.9              | 0.6                  | -                       |
| Interest coverage (times)                            | 21.8             | 19.6                 | -                       |

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

## Status of non-cooperation with previous CRA: Not applicable

## Any other information: None

## Rating history for past three years

| Current Rating (FY2023) |             |                          |   |                  | Chronology of Rating History for the past 3 years |                                 |                                 |                               |                               |
|-------------------------|-------------|--------------------------|---|------------------|---|---------------------------------|---------------------------------|-------------------------------|-------------------------------|
| Instrument              | Type        | Amount Rated (Rs. crore) | Amount Outstanding as on Mar 31, 2022 (Rs. crore) | Date & Rating on | Date & Rating in FY2022                           |                                 |                                 | Date & Rating in FY2021       | Date & Rating in FY2020       |
|                         |             |                          |   |                  | 08-Sep-2022                                       | 21-Feb-2022                     | 10-Feb-2022                     | 31-Dec-2020                   | 13-Jun-2019                   |
| 1                       | Cash Credit | Long Term                | 20.00   | 8.65             | [ICRA]BBB (Stable)                                | [ICRA]BBB- (Positive)           | [ICRA]BBB- (Positive)           | [ICRA]BBB- (Stable)           | [ICRA]BBB- (Stable)           |
| 2                       | Term Loan   | Long Term                | 1.58  | -                | [ICRA]BBB (Stable)                                | [ICRA]BBB- (Positive)           | [ICRA]BBB- (Positive)           | [ICRA]BBB- (Stable)           | [ICRA]BBB- (Stable)           |
| 3                       | Untied      | Long Term / Short Term   | 2.07  | -                | [ICRA]BBB (Stable)/ [ICRA]A3+                     | [ICRA]BBB- (Positive)/ [ICRA]A3 | [ICRA]BBB- (Positive)/ [ICRA]A3 | [ICRA]BBB- (Stable)/ [ICRA]A3 | [ICRA]BBB- (Stable)/ [ICRA]A3 |

## Complexity level of the rated instruments

| Instrument                         | Complexity Indicator |
|------------------------------------|----------------------|
| Long-term fund-based – Cash Credit | Simple               |
| Long-term fund-based – Term Loan   | Simple               |
| Long-term / Short-term – Untied    | NA                   |

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: [www.icra.in](http://www.icra.in)

## Annexure I: Instrument details

| ISIN | Instrument Name                      | Date of Issuance | Coupon Rate | Maturity | Amount Rated (RS Crore) | Current Rating and Outlook     |
|------|--------------------------------------|------------------|-------------|----------|-------------------------|--------------------------------|
| NA   | Long-term – Fund-based – Cash Credit | NA               | NA          | NA       | 20.00                   | [ICRA]BBB (Stable)             |
| NA   | Long-term – Fund Based - Term Loan   | FY2016           | NA          | FY2024   | 1.58                    | [ICRA]BBB (Stable)             |
| NA   | Long-term / Short-term – Untied      | NA               | NA          | NA       | 2.07                    | [ICRA]BBB (Stable) / [ICRA]A3+ |

Source: Company

[Please click here to view details of lender-wise facilities rated by ICRA](#)

## Annexure II: List of entities considered for consolidated analysis

| Company Name   | LTHL Ownership | Consolidation Approach |
|----------------|----------------|------------------------|
| Not Applicable |                |                        |

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