

February 10, 2022

SM Electronic Technologies Pvt. Ltd.: Ratings reaffirmed at [ICRA]BBB- /[ICRA]A3; Outlook revised to Positive from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund-based – Cash Credit	10.00	10.00	[ICRA]BBB-; outlook revised to Positive from Stable
Long-term – Fund Based - Term Loan	1.58	1.58	[ICRA]BBB-; outlook revised to Positive from Stable
Long-term / Short-term – Untied	2.07	2.07	[ICRA]BBB-/ [ICRA]A3; outlook revised to Positive from Stable
Total	13.65	13.65	

*Instrument details are provided in Annexure-1

Rationale

The revision in the outlook to Positive from Stable factors in SM Electronic Technologies Pvt Ltd's (SMET) significant pick-up in order execution in the current fiscal, and healthy order addition pipeline in FY2023, especially from the fast-growing electric vehicle (EV) and consumer durable segments. The reaffirmation of the ratings continues to factor in the established track record of SMET's management in developing, trading and distributing a wide range of electronic components for customers spanning across various segments such as 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. ICRA notes that development of ready solutions for supply of electronic components in the electronic vehicle segment has the potential to accelerate the revenue and earnings growth of the company over the near-to-medium term. The ratings further factor in the company's healthy capital structure and coverage indicators owing to low dependence on debt. SMET is currently under discussion with Satori Electronic Co. Ltd.¹ for acquisition of a 25.1% equity stake for a consideration of ~Rs. 25 crore. The successful closure of this equity raising plan would further strengthen SMET's capitalisation and credit metrics in FY2023.

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 industry downturn. The ratings also consider the elevated competition prevailing in the industry due to limited entry barriers and low capital intensity. ICRA notes that the company is also exposed to high foreign currency fluctuation risks on account of significant dependence on imports, which remain largely unhedged.

Key rating drivers and their description

Credit strengths

Significant increase in order inflow in current fiscal following greater traction from new segments like electric two-wheelers and consumer durables – The company has witnessed a surge in order inflow in 9M FY2022 owing to development of new product prototypes such as development of TFT (thin-film-transistor) LCD cluster display for installation in electric two-wheelers and external EV charger that can be plugged in normal sockets. Moreover, the company has successfully developed BLDC (Brushless DC Motor) drives for ceiling fans, which reduce energy consumption, allow variable speed control and changes

¹ 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

in rotational direction of the fans, giving them a compelling use case over conventional ceiling fans. SMET has also started discussions with China-based EVE Battery for the supply of a more compact and energy dense lithium ion battery to be used in EVs. ICRA expects that these recent product developments and collaborations will aid the company to sustain higher growth in revenue in the coming years.

Extensive experience of promoters and management team in the industry – SMET has been involved in the 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 2,000 customers. The revenues are fairly diversified, with the top ten customers contributing ~35% to the total sales in FY2021. 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, 2021. The coverage indicators remained healthy in FY2021, as indicated by an interest coverage of 21.1 times, NCA/Total debt of 82.5%, and Total Debt / OPBDITA of 0.9 times. SMET is currently under discussion with Satori Electronic Co. Ltd. for acquisition of a 25.1% equity stake for a consideration of ~Rs. 25 crore². Successful closure of this equity raising plan would further strengthen SMET's capitalisation and credit metrics in FY2023.

Credit challenges

Moderate scale of operations – The scale of operations remained modest with an operating income (OI) of Rs. 127.66 crore in FY2021, which improved only marginally from Rs. 121.91 crore in FY2020 on account of supply side disruptions from China amid Covid-19 and slowdown in demand of electronic components in the first half year of FY2021. The company's profits improved in FY2021 owing to lower fixed costs mainly due to lower remuneration from the senior management, lower marketing expenses and forex gains. In 9M FY2022, the company has recorded revenues of Rs. 160 crore and expects to achieve a healthy top line growth, going forward, backed by a strong orders 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 owing to high proportion of import – The company is exposed to foreign currency fluctuations as ~80-90% of the products are imported from component suppliers located outside India. However, the

² As per the initial discussion with the investor, SMET would issue new shares of Rs.20.1 crore (20.1% equity stake) in value and remaining Rs. 5 crore (5% equity stake) will be purchased by the investor from SMET's existing shareholders.

company's practice of marking up its quoted contract prices by ~3% helps in partly compensating for any adverse movement in foreign currency fluctuations.

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 January 2021 to December 2021 stood at 38% of the sanctioned limits. The cash credit facilities were enhanced to Rs. 20 crore in May 2021 from Rs. 10 crore, which has increased the liquidity headroom. Moreover, the company had unencumbered cash balances of Rs. 1.65 crore as on September 30, 2021, which supports the company's liquidity position.

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 2 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
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 company 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

STPL (Standalone)	FY2020 (Audited)	FY2021 (Audited)
Operating Income (Rs. crore)	121.91	127.66
PAT (Rs. crore)	3.88	5.38
OPBDIT/OI (%)	5.29%	6.45%
PAT/OI (%)	3.18%	4.21%
Total Outside Liabilities/Tangible Net Worth (times)	0.96	1.07
Total Debt/OPBDIT (times)	0.46	0.93
Interest Coverage (times)	11.69	21.83

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	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on Dec 31, 2021 (Rs. crore)	Date & Rating on	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					10-Feb-2022	31-Dec-2020	13-Jun-2019	05-Oct-2018
1	Cash Credit	Long Term	10.00	8.21	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BB+ (Positive)
2	Term Loan	Long Term	1.58	-	[ICRA]BBB- (Positive)	[ICRA]BBB- (Stable)	[ICRA]BBB- (Stable)	[ICRA]BB+ (Positive)
3	Unallocated	Long Term / Short Term	2.07	-	[ICRA]BBB- (Positive)/[ICRA]A3	[ICRA]BBB- (Stable)/[ICRA]A3	[ICRA]BBB- (Stable)/[ICRA]A3	[ICRA]BB+ (Positive)/[ICRA]A4+

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 analyzing 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, is available on ICRA's website: www.icra.in

Annexure-1: Instrument details

ISIN No/Banker Name	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	10.00	[ICRA]BBB- (Positive)
NA	Long-term – Fund Based - Term Loan	NA	NA	NA	1.58	[ICRA]BBB- (Positive)
NA	Long-term / Short-term – Untied	NA	NA	NA	2.07	[ICRA]BBB- (Positive) / [ICRA]A3

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Not Applicable		

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