March 31, 2023

SMPP Private Limited: Ratings reaffirmed; Outlook revised to Positive from Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Cash Credit	5.00	5.00	[ICRA]A (Positive) reaffirmed; Outlook revised to Positive from Stable
Non Fund-Based Facilities	242.64	117.12	[ICRA]A1 reaffirmed
Unallocated Limits	2.36	127.88	[ICRA]A (Positive)/[ICRA]A1 reaffirmed; Outlook revised to Positive from Stable
Total	**250.00**	**250.00**	

**Instrument details are provided in Annexure-I*

Rationale

The revision in the outlook to "Positive" for SMPP factors in the expected improvement in the credit risk profile of the entity driven by healthy incremental order inflow from the domestic as well as export markets, healthy cash generation supported by increased scale and low operating leverage along with strong liquidity position going forward. SMPP completed a multi-year supply order worth Rs. 639 crores for Bullet Proof Jackets (BPJs) from Ministry of Defence (MoD) in November 2021 well ahead of schedule. As a result of successful completion of the afore-mentioned order, SMPP has been able to establish its capability to deliver large size orders, which has aided incremental order inflows in FY2022 and FY2023 from the domestic as well as export markets. Thus, going forward, ICRA expects SMPP to win major share of tenders being floated for BPJs in the domestic market. The company is also focusing on export markets and recent completion of two sizeable orders from the European market, will aid incremental export order inflow. ICRA notes that given the tender based business in the domestic market, the order inflow can be lumpy which may lead to variation in the revenue going forward and will remain a key monitorable. With improvement in the scale of operations, strong order book position and low operating leverage, the cash generation for the company is expected to remain healthy going forward. ICRA expects the liquidity position for SMPP to remain strong going forward as well given the expectation of healthy cash generation and no debt on the books of the company. ICRA notes that SMPP plans to make sizeable investment in its newly formed subsidiary SMPP Ammunitions Private Limited. Given the expectation of healthy cash accruals going forward and large free cash balances currently, the liquidity position of the company will remain strong even if the entire investments, Rs 200 crore over FY2024 and FY2025, are met through internal accruals. The ratings continue to factor in the established presence of the company and extensive experience of the promoters in the ballistic equipment industry, ability of the company to meet the stringent quality tests and specifications which remain a major entry barrier for the industry.

The ratings are constrained by the customer concentration risk and lumpiness in the order receipt due to the tender-based business and susceptibility of the profitability of commodity and forex risks. Since SMPP operates in a tender based business in the domestic market, the order inflow can be lumpy. The company's raw material is largely imported which exposes the company to commodity price risk as well as forex risk as the company does not hedge its foreign exchange exposure. The company manages commodity price risk by negotiating with the suppliers and placing large size orders for procurement while with increase in export orders, part of the forex risk gets naturally hedged. SMPP's operations are also exposed to meeting the strict quality standards and tender specifications for the orders. Inability to meet the quality specified in the tender can lead to financial implications as well as reputational risk.

Key rating drivers and their description

Credit strengths

Established presence in ballistic equipment industry supported by extensive experience of promoters – SMPP's promoters have more than three decades of experience in the ballistic protection equipment industry. It has an established track record of executing many orders for various defense forces in the domestic and export markets. This, along with technical expertise and in-house product development, has enabled the company to receive repeat orders from its major customers and has also helped it secure a significant order from the MoD.

Stringent quality specifications and time taken for approvals result in high entry barriers – In the domestic markets, the consumers of defence products majorly are the government agencies which have strict quality specifications. The quality and testing requirements for the bullet proof jackets remain stringent owing to the criticality of the product. Since the products undergo stringent testing and approvals before a supplier is approved, the approval time for getting approved from the agencies can be long. The licencing required to supply to these government agencies also acts as a barrier to entry in the segment. While stringent quality inspections remain a key barrier to entry, the same can result in financial loss also if the company fails to meet the requirements in an order. SMPP has been able to mitigate the risk by building in factors of safety over and above the requirements leading to low probability of inability of the company to meet the quality norms.

Strong financial risk profile – SMPP's credit profile is characterised by debt free operations with large un-encumbered cash balances the company holds. The company's profitability has been on an uptrend for the last couple of years with the increase in the scale of operations as it executed a major order from the Ministry of Defence (MoD) from FY2019 till FY2022. Going forward, with expectation of brisk order inflow for the company both from the domestic segment as well as the export markets where the company has recently found footing should keep the profitability healthy and support the overall financial risk profile.

Credit challenges

Customer concentration risk along with lumpiness in order receipt due to tender based business – The top five customers accounted for 91% of its revenues in FY2022. This was mainly due to a large Ministry of Defence (MoD) order being executed by the company. Thus, exposing the company to high customer concentration risk. Nonetheless, majority of the customers are reputed government entities which reduces counterparty risk. The future revenue growth also hinges on incremental order inflow from the government agencies which remains lumpy due to tendering nature of the business. However, focus of GoI on increasing the share of domestic sourcing in the defence segment should provide support to order inflow for the company.

Susceptibility of profit margins to raw material price and foreign exchange rate fluctuations – The company's contracts are fixed price in nature and thus remain exposed to fluctuation in the commodity price risk as well forex fluctuations given the raw material is largely imported. While the company does not have hedging policy for forex risk, the contracts for majority of the orders are short term contracts and thus the company so far has not witnessed any significant impact on this front. For long tenor orders like MoD's order that spanned three years, the contract had built in protections against foreign exchange fluctuations which provided protection against forex fluctuations. In case of export orders a natural hedge is provided given the realisations are also dollar denominated.

Liquidity position: Strong

SMPPs liquidity is **strong** as characterised by nil working capital utilisation and large unencumbered cash balances to the extent of Rs. 250 crores as on December 31, 2022. Given the debt free operations, company does not have any scheduled repayments. ICRA notes that the company has signed an MoU with Government of Himachal Pradesh to setup a manufacturing unit in the state. The liquidity position of the company is expected to remain strong even after the envisaged investments in the near to medium term.

Rating sensitivities

Positive factors – The entity's rating maybe upgraded in a scenario of material increase in the scale of operations along with stable profit margins.

Negative factors – Pressure on the ratings could arise if there is a significant decline in profitability as well as deterioration in its working capital cycle diminishing the company's liquidity. Material contraction in the order book position leading to weak revenue visibility could also lead to a rating downgrade for SMPP. Materially large capex and/or higher than envisaged investments in the upcoming subsidiary leading to weaking of the standalone credit profile will remain a key rating sensitivity. Specific credit metrics that may result in a downgrade include TOL/TNW of more than 1.3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings ICRA has considered the standalone financials of SMPP Private Limited

About the company

Established in 1985 by Mr. S.C. Kansal, SM Pulp Packaging Private Limited (SMPP Private Limited) manufactures ballistic protection equipment like bullet-proof jackets, helmets, bullet proof shields etc., and combustible cartridge cases (CCC). It is the first entity in India that started manufacturing CCCs indigenously. Apart from this, the company has also supplied kits for A400 Airbus armoring program. The company's manufacturing unit is situated at Palwal (Haryana) with major clients as Indian Army, Ministry of Defense (MoD), Paramilitary Forces, State Police and other government departments. SMPP also exports Boron Carbide Ceramic Plates and Hard Armour Plates which is a critical raw material required for light weight bullet proof jackets to countries like France, Saudi Arabia, Israel, Austraila, Korea etc.

Key financial indicators (audited)

SMPP Standalone	FY2021	FY2022
Operating income	279.7	366.9
PAT	38.8	87.7
OPBDIT/OI	18.3%	30.0%
PAT/OI	13.9%	23.9%
Total outside liabilities/Tangible net worth (times)	0.6	0.3
Total debt/OPBDIT (times)	0.0	0.0
Interest coverage (times)	107.9	97.9

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

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years					
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2022 (Rs. crore)	Date & Rating on	Date & Rating in FY2022	Date & Rating in FY2021		Date & Rating in FY2020		
					31-03-2023	21-Dec-21	28-Oct-20	14-Aug-20	4-Nov-19	4-Oct-19
1	Cash Credit	Long Term	5	-	[ICRA]A (Positive)	[ICRA]A (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Non Fund-Based Facilities-Bank Guarantee/ Letter of Credit	Short Term	117.12	-	[ICRA]A1	[ICRA]A1	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+	[ICRA]A2+
3	Unallocated	Long term/short term	127.88	-	[ICRA]A (Positive)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]BBB+ (Stable)/ [ICRA]A2+	[ICRA]BBB+ (Stable)/ [ICRA]A2+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Cash Credit	Simple
Non Fund-Based Facilities	Very Simple
Unallocated Limits	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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	NA	NA	NA	5.00	[ICRA]A (Positive)
NA	Non-Fund Based Facilities-Bank Guarantee/ Letter of Credit	NA	NA	NA	117.12	[ICRA]A1
NA	Unallocated	NA	NA	NA	127.88	[ICRA]A (Positive)/ [ICRA]A1

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: List of entities considered for consolidated analysis-NA

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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.

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