December 28, 2023

SM Electronic Technologies Pvt. Ltd.: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term – Fund based – Cash credit	20.00	20.00	[ICRA]BBB (Stable); reaffirmed
Long-term – Fund based – Term loan	1.58	1.58	[ICRA]BBB (Stable); reaffirmed
Long-term / Short-term – Unallocated	2.07	2.07	[ICRA]BBB (Stable)/ [ICRA]A3+; reaffirmed
Total	**23.65**	**23.65**	

**Instrument details are provided in Annexure-I*

Rationale

ICRA has revised its analytical approach for arriving at SM Electronic Technologies Pvt. Ltd.'s (SMET) ratings based on standalone financials to consolidated financials, following its recent acquisition of 100% ownership of SMET Singapore Pte. Ltd (SMET Singapore, formerly known as Singapore Satori Pvt Ltd). ICRA has also factored in the implicit financial support expected from SMET's parent, Satori Electric Co., Ltd. (Satori), following SMET becoming a subsidiary of Satori, with an increase of Satori's ownership to 50.1% (from 21.16% earlier) in SMET.

The ratings reaffirmation for SMET favourably factor in the company's better-than-expected revenue growth in H1 FY2024 due to a significant pick-up in order execution, especially in the newly acquired subsidiary in Singapore. ICRA expects the company's healthy revenue growth to continue for the remainder of FY2024, aided by a combination of factors, including access to Satori's global supply chains and healthy demand prospects for electronic components in India, especially by the anticipated strong growths in the electric vehicle (EV) and consumer durable segments in the medium term. ICRA believes that SMET's access to Satori's customers, design capabilities, suppliers, as well as its distribution networks strengthens SMET's product/service delivery capabilities. This could open up new growth avenues, in turn supporting a significant scale-up in turnover over the medium term. In addition, ICRA believes that product development in new segments such as medical diagnostics and postal services would also support SMET in scaling up its overall operations from the prevailing levels. 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, aiding the company in developing new solutions and getting repeat orders from its established clientele.

The ratings, however, are constrained by the significant increase in external financing and the subsequent deterioration of leverage/coverage metrics post the acquisition of SMET Singapore, making the company more vulnerable during a sustained period of weak earnings in potential future downturns in the industry. Additionally, the weaker profit margins of SMET Singapore, in comparison to the standalone entity, exert a drag on the overall profitability of the consolidated entity. Given that the scale-up of SMET Singapore's operations is being largely aided through dependence on external financing, through a mix of working capital borrowings and/or creditors, SMET's consolidated leverage metrics are expected to remain suppressed till the time the earnings of the overseas operations improve meaningfully going forward. However, ICRA understands that Satori has provided a corporate guarantee for the working capital borrowing facilities availed by SMET Singapore, which demonstrates its intent to support the overseas operations during the ongoing process of scale-up. The ratings also consider the elevated competition prevailing in the industry, attributed to limited entry barriers and low capital intensity. The intense competition, coupled with low bargaining power with much larger customers, limits the 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 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 the favourable operating environment, supported by the traction in order inflow from the EV and consumer durable segments, which has 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

Strategic partnership with Satori expected to strengthen product/service delivery capabilities – In March 2022, Satori acquired a 21.16% stake in SMET and formed a strategic partnership with SMET to expand its geographic reach. Further, towards the end of FY2023, Satori increased its shareholding in SMET to 50.1% through a fresh issue for 20.1% of the shareholding, against which SMET Singapore was offered to SMET, and the remaining portion was acquired through a secondary purchase from the existing promoters, establishing SMET as a partly owned subsidiary of the Japanese parent. The benefits of this acquisition are expected to flow both ways, with Satori's parentage providing SMET access to Satori's customers, design capabilities, suppliers, as well as its distribution networks, strengthening SMET's product/service delivery capabilities. This could open up new growth avenues, supporting a significant scale-up in turnover over the medium term. Besides, Satori is also expected to gain from its access to SMET's design labs and its customer solutions offerings for its own customers.

Improvement in its market position with increase in its scale of operations – With the recent acquisition of SMET Singapore and the aggressive growth plan leveraging on the support from Satori, SMET is expected to significantly scale up its turnover in FY2024 by more than 100% against the levels achieved in FY2023. The growth will be aided by a combination of factors, including access to Satori's global supply chains and healthy demand prospects for electronic components in India, especially from the strong demand anticipated in the EV and consumer durable segments. The overall profitability might moderate to some extent during the ongoing scale-up process, wherein margins of the overseas business remain much weaker than the standalone operations. However, the same has the potential to make SMET one of the important players in the Indian electronics component industry.

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 relationships with its electronic component suppliers 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 ~44% to the total sales in FY2023. Further, SMET's products find application in various industries and cater to customers from different sectors such as energy, automotive, Defence and aerospace, mobility, and industrial segments, partly mitigating the risk of a sharp earnings volatility stemming 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.

Credit challenges

Significant increase in external financing and deterioration of leverage/coverage metrics following acquisition of SMET Singapore – In FY2024, SMET consolidated revenue is expected to scale up to ~Rs. 1,000 crore, representing a year-over-year

(YoY) growth of ~140% in FY2023[1] (consolidated revenue of Rs. 421 crore). However, due to the trading-based business model and the ongoing growth phase in the overseas subsidiary, the cash accruals remain insufficient to fund the working capital needs, compelling it to fund the scale-up through external financing (working capital debt and creditors). Modest net worth as well as an increase in the leverage on the balance sheet of the company is expected to increase the TOL/TNW to more than 3 times in FY2024 from 1.4 times in FY2023, making the company more vulnerable to weakness in earnings amid a sustained downturn in the industry and/or a deterioration in the working capital cycle.

Thin profit margin of the overseas Singapore subsidiary; a drag on the overall profitability – Prior to the acquisition, SMET Singapore on a standalone basis generated a revenue of Rs. 125 crore in FY2022 and Rs. 187 crore in FY2023. However, the earnings remained constrained with the OPBDITA being close to breakeven in both the fiscals. Following the change in ownership, under the new business model, where SMET Singapore has been tapping into SMET's established customer base in India, the performance has started to show signs of a turnaround. In H1 FY2024, SMET Singapore generated a revenue of Rs. 348 crore and an improved OPBDITA margin of 1.8%. That said, the profitability is still lower than the standalone India operations, which typically generate operating margins of 5-7%, leading to a drag on the overall margins on a consolidated basis.

High competitive intensity 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 such as Avenet Inc., Arrow Electronics and other small-scale distributors and traders. High degree of 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.

Liquidity position: Adequate

The limited capex requirement of the business results in an adequate liquidity position for the company. The average utilisation of cash credit facilities in SMET's India business during July 2022 to September 2023 stood at 38% of the sanctioned limits. In addition, the working capital facilities of $ 30 million (~Rs. 250 crore) in SMET Singapore, of which ~ Rs. 225 crore has been drawn as of September 30, 2023, provide further cushion to the overall consolidated liquidity. Besides, the company maintained an unencumbered cash balance of ~Rs. 21 crore as on September 30, 2023, further supporting its liquidity position. In addition, SMET has minimal external term debt loan repayment obligations of ~Rs. 0.5 crore per annum in FY2024 and FY2025, which are expected to be managed through internal accruals, further supporting the overall liquidity.

Rating sensitivities

Positive factors – The ratings may be upgraded if there is a healthy growth in profits and strengthening of the net worth while strengthening its credit metrics on a sustained basis.

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 or an elongation in the working capital cycle, leading to a deterioration in credit metrics and weakening of the liquidity position. The ratings could also come under pressure in case there is a deterioration in the parent company's credit risk profile or weakening of SMET's linkages with its parent company. Specific metric which could lead to a ratings downgrade is interest cover declining below 2.5 times on a sustained basis.

[1] Singapore operations consolidated w.e.f. February 1, 2023

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	[Corporate Credit Rating Methodology]
Parent/Group support	The ratings for SMET factor in the reasonable likelihood of its parent, Satori Electric Co., Ltd. (having 50.1% shareholding in SMET), extending financial support to it due to the close business linkages between them and given the strategic importance that SMET holds for Satori for meeting its diversification objectives.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of SMET. The list of companies consolidated is shared in Annexure-II.

About the company

Established in 1990 as a partnership firm by Mr. Manjunath, SMET was converted into a private limited in 2004. It is involved in the 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 and a recently acquired overseas subsidiary (SMET Singapore). SMET has an association with over 50 foreign suppliers of electronic components, including Renesas, Tianma, Fujitsu, Seiko, Epson, Rohm Semiconductor, and others.

Towards the end of FY2023, Satori through the increase in its shareholding to 50.1% became the parent company of SMET. As a consideration, Satori offered its Singapore subsidiary to SMET, making SMET Singapore a wholly owned subsidiary of SMET. SMET Singapore is also involved in trading, distribution and supply chain management of electronic components and is presently serving its existing clientele as well as SMET India’s customer base.

Key financial indicators

SMET - Audited	FY2022 (standalone)	FY2023 (consolidated)
Operating income	231.7	420.8
PAT	10.1	10.3
OPBDIT/OI	7.0%	4.6%
PAT/OI	4.4%	2.5%
Total outside liabilities/Tangible net worth (times)	0.9	1.4
Total debt/OPBDIT (times)	0.6	2.3
Interest coverage (times)	14.8	10.6

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

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the past 3 years			
		Type	Amount Rated (Rs. crore)	Amount Outstanding as on March 31, 2023 (Rs. crore)	Date & Rating on	Date & Rating in FY2023	Date & Rating in FY2022		Date & Rating in FY2021
					28-Dec-2023	08-Sep-2022	21-Feb-2022	10-Feb-2022	31-Dec-2020
1	**Long-term fund-based – Cash Credit**	Long Term	20.00	-	**[ICRA]BBB (Stable)**	**[ICRA]BBB (Stable)**	**[ICRA]BBB- (Positive)**	**[ICRA]BBB- (Positive)**	**[ICRA]BBB- (Stable)**
2	**Long-term fund-based – Term Loan**	Long Term	1.58	1.58	**[ICRA]BBB (Stable)**	**[ICRA]BBB (Stable)**	**[ICRA]BBB- (Positive)**	**[ICRA]BBB- (Positive)**	**[ICRA]BBB- (Stable)**
3	**Long-term / Short-term – Unallocated**	Long Term / Short Term	2.07	-	**[ICRA]BBB (Stable)/ [ICRA]A3+**	**[ICRA]BBB (Stable)/ [ICRA]A3+**	**[ICRA]BBB- (Positive)/ [ICRA]A3**	**[ICRA]BBB- (Positive)/ [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 – Unallocated	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	**Long-term – Fund-based – Cash credit**	NA	NA	NA	20.00	[ICRA]BBB (Stable)
NA	**Long-term – Fund Based - Term loan**	FY2016	NA	FY2027	1.58	[ICRA]BBB (Stable)
NA	**Long-term / Short-term – Unallocated**	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	Ownership	Consolidation Approach
SMET Singapore Pte. Ltd.	100.00%	Full consolidation

Source: Company, Data as on March 31, 2023

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About ICRA Limited:

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