B.Melaram & Sons: Long-term rating downgraded to [ICRA]B+(Stable) and short-term rating reaffirmed; rated amount enhanced

Summary of rating action

<table>
<thead>
<tr>
<th>Instrument*</th>
<th>Previous Rated Amount (Rs. crore)</th>
<th>Current Rated Amount (Rs. crore)</th>
<th>Rating Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Long-term fund based limit</td>
<td>(7.00)</td>
<td>(7.00)</td>
<td>[ICRA]B+(Stable) Downgraded from [ICRA]BB-(Stable)</td>
</tr>
<tr>
<td>Short-term non fund based limit</td>
<td>35.00</td>
<td>40.00</td>
<td>[ICRA]A4 Reaffirmed</td>
</tr>
<tr>
<td>Total</td>
<td>35.00</td>
<td>40.00</td>
<td></td>
</tr>
</tbody>
</table>

*Instrument details are provided in Annexure

Rationale

The rating downgrade of B.Melaram & Sons (BMS) considers the worsening cost structure of the firm, caused by increase in input costs resulting in decline in profitability in FY2019. The firm’s profit margins have remained modest because of lack of value addition and intense competition in steel trading, which limits its pricing flexibility. Further, the profitability is susceptible to fluctuations in foreign exchange rates and steel prices. The operations of BMS have also been exposed to the cyclicality in the steel industry. The company’s reliance on Letter of Credit (LC) backed creditors to fund its working capital requirements have resulted in a high TOL/TNW\(^1\) ratio of 3.07 times as on March 31, 2019. The rating is further constrained by the entity’s status as a partnership firm, which exposes it to the risk of capital withdrawals by the partners, as evident in the past.

The rating, however, takes comfort from the extensive experience of the promoters in the steel trading and ship-breaking businesses.

Outlook: Stable

ICRA expects BMS to continue to benefit from the experience of the management in steel trading. The outlook may be revised to Positive if there is a sustained increase in the firm’s scale of operations and profit margins. The outlook may be revised to Negative if there is any further decline in profitability or stretch on the working capital cycle adversely impacting the liquidity profile of the firm.

Key rating drivers

Credit strengths

**Extensive experience of promoters in steel trading** - BMS was established by Mr. Melaram Baijnath Agarwal in 1982 and was later taken over by his sons, Mr. Vinodkumar M. Agarwal and Mr. Bhupendrakumar M. Agarwal. Both the partners

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\(^1\) Total Outside Liabilities/Tangible Net worth

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hold over two decades of experience in steel trading. The partners’ extensive experience has enabled the firm to establish healthy business relationships with its suppliers and customers.

Credit challenges

Worsening cost structure from rising input costs led to decline in profitability in FY2019; profitability exposed to intense competition in the industry as well as to fluctuations in the currency market – The profitability of BMS has been modest due to the lack of value addition in the trading business. The cost structure has weakened in FY2019 due to rise in input costs, which has deteriorated the profitability. The operating profit margin declined to 0.77% in FY2019 from 2.76% in FY2018. High bank charges and forex loss have resulted in a net loss of Rs. 0.35 crore in FY2019. Given the high volatility in steel prices and inventory maintained by the firm due to its reliance on imports, the margins are also exposed to inventory risks. Moreover, in the absence of a natural hedging mechanism, the profitability remains vulnerable to foreign exchange fluctuations as the firm imports most of its traded goods. Due to the fragmented nature of operations and low entry barriers with respect to capital and technical intensity, the competitive intensity has been high in the industry.

Exposure to cyclicality associated with the steel industry – The company’s operations and profitability are vulnerable to the cyclicality inherent in the steel trading business. The impact of fluctuation in global as well as domestic demand and prices has been visible in the top line movement of the firm over the past five years.

Reliance on LC-backed creditors to fund working capital requirements result in high TOL/TNW of 3.07 times as on March 31, 2019 – The usage of fund-based facilities for procuring metals has been limited and the firm relies largely on its suppliers to fund the operations. It enjoys a credit of 90-180 days on it LC-backed purchases, which has kept the TOL/TNW high at 3.07 times as on March 31, 2019.

Risk of capital withdrawal due to constitution as partnership firm - BMS being a partnership firm, any significant withdrawals from the capital account by its partners could impact its net worth. The capital withdrawals in FY2018 along with the net loss in the consecutive year have led to erosion in net worth, which stood at Rs. 9.38 crore as on March 31, 2019 (as compared to Rs. 11.77 crore as on March 31, 2017).

Liquidity position

The company’s liquidity profile remained moderate with an average working capital utilisation of 53% for both fund-based and non-fund based limits during the 15-month period that ended on July 2019. The firm currently has zero long-term debt repayment liability and no capital expenditure requirement. The approximate value of LCs outstanding as on July 31, 2019 was Rs. 22.62 crore.

Analytical approach

<table>
<thead>
<tr>
<th>Analytical Approach</th>
<th>Comments</th>
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</thead>
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<tr>
<td>Applicable Rating Methodologies</td>
<td>Corporate Credit Rating Methodology</td>
</tr>
<tr>
<td>Parent/Group Support</td>
<td>Not applicable</td>
</tr>
<tr>
<td>Consolidation/Standalone</td>
<td>Standalone</td>
</tr>
</tbody>
</table>

About the company

Established in 1980, BMS is a partnership concern that trades in ferrous products like hot rolled (HR) coils, HR plates and sheets, HR alloys, etc. The firm was also engaged in ship breaking, which was discontinued from FY2013 due to
slowdown in the industry. Baijnath Melaram (rated [ICRA]BB(Stable)/[ICRA]A4+) is the associate concern of BMS, engaged in ship-breaking operations.

In FY2019 (provisional), BMS reported a net loss of Rs. 0.35 crore on an operating income (OI) of Rs. 95.52 crore, compared to a profit before tax of Rs. 2.18 crore on an OI of Rs. 91.64 crore in FY2018.

**Key financial indicators**

<table>
<thead>
<tr>
<th></th>
<th>FY2018 Audited</th>
<th>FY2019 Provisional</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Income (Rs. crore)</td>
<td>91.64</td>
<td>95.52</td>
</tr>
<tr>
<td>PAT (Rs. crore)</td>
<td>2.18</td>
<td>(0.35)</td>
</tr>
<tr>
<td>OPBDITA/ OI (%)</td>
<td>2.78%</td>
<td>0.77%</td>
</tr>
<tr>
<td>RoCE (%)</td>
<td>19.61%</td>
<td>5.52%</td>
</tr>
<tr>
<td>Total Debt/ TNW (times)</td>
<td>0.25</td>
<td>0.24</td>
</tr>
<tr>
<td>Total Debt/ OPBDITA (times)</td>
<td>1.04</td>
<td>3.07</td>
</tr>
<tr>
<td>Interest Coverage (times)</td>
<td>3.08</td>
<td>0.71</td>
</tr>
</tbody>
</table>

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

**Any other information: None**

**Rating history for last three years**

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Amount Rated (Rs. crore)</th>
<th>Amount Outstanding (Rs. crore)</th>
<th>Date &amp; Rating August 2019</th>
<th>Date &amp; Rating in FY2019</th>
<th>Date &amp; Rating in FY2018</th>
<th>Date &amp; Rating in FY2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td><em>Long-term</em></td>
<td>(7.00)</td>
<td>-</td>
<td>[ICRA]B+ (Stable)</td>
<td>[ICRA]BB- (Stable)</td>
<td>[ICRA]B+ (Stable)</td>
</tr>
</tbody>
</table>

**Complexity level of the rated instrument**

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website [www.icra.in](http://www.icra.in)
### Annexure: Instrument Details

<table>
<thead>
<tr>
<th>ISIN No</th>
<th>Instrument Name</th>
<th>Date of Issuance/Sanction</th>
<th>Coupon Rate</th>
<th>Maturity Date</th>
<th>Amount Rated (Rs. crore)</th>
<th>Current Rating and Outlook</th>
</tr>
</thead>
<tbody>
<tr>
<td>-</td>
<td>Cash Credit*</td>
<td>-</td>
<td>12.65%</td>
<td>-</td>
<td>(7.00)</td>
<td>[ICRA]B+(Stable)</td>
</tr>
<tr>
<td>-</td>
<td>Letter of Credit</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>40.00</td>
<td>[ICRA]A4</td>
</tr>
</tbody>
</table>

*Sub-limit of Letter of Credit

Source: B.Melaram & Sons
ANALYST CONTACTS

K. Ravichandran
+91 44 4596 4301
ravichandran@icraindia.com

Suprio Banerjee
+91 22 6114 3443
supriob@icraindia.com

Rupa Pandey
+91 22 6114 3456
rupa.pandey@icraindia.com

Srideep Datta
+91 22 6114 3451
srideep.datta@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:
+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)
info@icraindia.com

About ICRA Limited:

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