

January 21, 2020

S M Steels: Ratings reaffirmed; outlook revised to Negative

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term, Fund-based Limits	16.00	16.00	[ICRA]BB+(Negative); rating reaffirmed; outlook revised from Stable to Negative
Short-term, Non-fund Based Limits	29.50	29.50	[ICRA]A4+; reaffirmed
Short-term, Interchangeable Limits	14.75 [^]	14.75 [^]	[ICRA]A4+; reaffirmed
Long-term and Short-term, Unallocated Limit	4.50	4.50	[ICRA]BB+(Negative) and [ICRA]A4+; rating reaffirmed; outlook revised from Stable to Negative
Total	50.00	50.00	

[^]Sub-limits of long-term, fund-based and short-term, non-fund based limits

*Instrument details are provided in Annexure-1

Rationale

The revision in the outlook on the long-term rating to Negative takes into consideration the weakening of the liquidity profile of SM Steels (SMS) in FY2019, following significant capital withdrawals by the partners. The firm's net worth has weakened further in the current year due to reduction in partner's capital due to retirement of partner. However, ICRA notes that the funds have been retained in the firm in form of interest-bearing unsecured loans.

The reaffirmation of ratings continues to remain constrained by the volatility in profits and cash flows due to the cyclical nature of the steel industry, elevated TOL/TNW levels (3.03 times as on March 31, 2019 over 2.69 times as on March 31, 2018) due to increasing reliance on external borrowings for meeting its working capital requirements. The ratings also factor in the high competitive intensity in the steel trading industry and risks associated with its status as a partnership firm.

Nevertheless, the ratings continue to derive comfort from extensive experience of the promoters and its diversified customer base, leading to low customer concentration risks. ICRA also notes the company's established position as an authorised dealer of Steel Authority of India Limited (SAIL), JSW Steel Limited (JSW) and Rashtriya Ispat Nigam Limited (RINL).

Key rating drivers and their description

Credit strengths

Significant experience of the promoter in the steel industry - SMS was established as a partnership firm in 1985 by Mr. Satish Shah and his wife, Mrs. Pratibha Shah. Presently, it is being managed by Mr. Satish Shah, who has an experience of more than three decades in the steel industry. The firm is engaged in trading structural steel products like angles, beams, channels and hot rolled (HR) coils, plates, thermo mechanically treated (TMT) bars, flats and rounds, among others.

Diversified customer base - The customer base of the firm are mainly steel traders, construction and engineering companies. The firm has a diversified customer base with the top five customers generating 14% and 19% of the total sales in FY2018 and FY2019, respectively. The firm's diversified customer base mitigates the risk of high concentration and the promoter's rich experience ensures smooth flow of orders from clients.

Established position as an authorised distributor for reputed steel manufacturers - The firm has been the authorised distributor of SAIL and JSW for over 15 years and for RINL over the past five years. It procures around 75-80% of its products from these manufacturers, which ensures uninterrupted supply of steel.

Credit challenges

Significant withdrawals by the partners - SMS's operating profit declined to 3.08% in FY2019 from 3.99% in FY2018 owing to pressure on sales realisation due to slowdown in demand. The firm's total outside liabilities/net worth ratio increased to 3.03 times in FY2019 from 2.69 times in FY2018, following significant capital withdrawals of Rs. 8.29 crore during the year. Furthermore, with retirement of a partner, the total net worth has reduced by Rs. 22.63 crore in the current year. ICRA notes that the retiring partner has retained the funds in the firm in form of interest-bearing unsecured loans, till new partners infuse additional capital. However, the same is expected to exert pressure on the net profit margin with increase in interest expense. The firm's ability to strengthen its net worth by infusion of capital by new partners will remain critical from a credit perspective.

Cyclical inherent in the steel industry, which is likely to keep cash flows volatile - The firm's profitability and cash flows remains vulnerable to the cyclical inherent in the steel trading business. The firm's profit margins have remained volatile during the period under review owing to changing demand-supply scenario and prices in domestic as well as international markets.

Exposure to intense competitive pressures on account of fragmented industry structure - The steel trading industry is fragmented and characterised by intense competition. The firm's competitors are a large number of organised and unorganised players, which restricts its pricing flexibility. However, the firm's established track record of operations and association with well reputed companies, such as SAIL, JSW and RINL, for procuring traded goods gives it an edge over its peers.

Liquidity position: Stretched

SMS's liquidity position is stretched with weakened accruals and significant withdrawals of capital in FY2019 and in the current year. With increasing scale of operations, the firm's reliance on channel financing has remained high, with almost full utilisation of limits in some months. While ICRA notes that the firm does not have any term loan outstanding as on date and the debt profile is predominantly short-term in nature, the partner's ability to strengthen its net worth by infusing capital to fund its operations will remain critical.

Rating sensitivities

Positive triggers – ICRA could upgrade the ratings if the firm sustains its top-line growth and improve its profit margin and accruals. Also, strengthening of its net worth and, thereby, the capitalisation ratios and liquidity profile will remain critical for a rating upgrade.

Negative triggers – Negative pressure on the ratings could arise if fluctuating steel prices affect the firm's profitability. Any material reduction in net worth or deterioration in capitalisation and coverage indicators due to non-conversion of unsecured loans in capital or continuing withdrawals of capital can also result in a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Trading Companies
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial statement of the issuer

About the company

SMS was established as a partnership firm in 1985 by Mr. Satish Shah and his wife, Mrs. Pratibha Shah. It is engaged in the trading of structural steel products such as angles, HR coils, plates, TMT bars, flats, rounds, beams and channels, among others. Apart from trading operations, SMS owns two wind turbines at Satara (Maharashtra) and Jaisalmer (Rajasthan). The electricity generated from these turbines is sold to the respective state electricity boards. The firm's registered office is at Reay Road, Mumbai. In August 2012, the firm opened a branch office in Ahmedabad (Gujarat) to expand its reach. The firm's warehouse is located at Kalamboli (Navi Mumbai).

The firm is the authorised dealer of various reputed companies like RINL, SAIL and JSW.

In FY2019, the firm reported a net profit of Rs. 6.72 crore on an operating income of Rs. 476.14 crore as compared to a net profit of Rs. 9.38 crore on an operating income of Rs. 417.77 crore in the previous year.

Key financial indicators (audited)

	FY2018	FY2019
Operating Income (Rs. crore)	417.77	476.14
PAT (Rs. crore)	9.38	6.72
OPBDIT/OI (%)	3.99%	3.08%
RoCE (%)	23.44%	15.93%
Total Outside Liabilities/Tangible Net Worth (times)	2.69	3.03
Total Debt/OPBDIT (times)	3.56	4.33
Interest Coverage (times)	4.03	2.66
DSCR	3.33	2.26

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Rating (FY2020)			Rating History for the Past 3 Years				
		Type	Amount Rated	Amount Outstanding	Current Rating 21-Jan-2020	FY2019		FY2017	FY2016
						4-Feb-2019	5-Apr-2018	25-Oct-2016	6-Jan-2016
1	Cash Credit	Long-term	8.00	-	[ICRA]BB+ (Negative)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)	[ICRA]BB (Stable)	[ICRA]BB (Stable)
2	Cash Credit	Long-term	8.00^^	-	[ICRA]BB+ (Negative)	[ICRA]BB+ (Stable)	[ICRA]BB+ (Stable)	[ICRA]BB (Stable)	[ICRA]BB (Stable)
3	Import/Inland LC	Short-term	14.75	-	[ICRA]A4+	[ICRA]A4+	[ICRA]A4+	[ICRA]A4	[ICRA]A4
4	Import/Inland LC	Short-term	14.75	-	[ICRA]A4+	[ICRA]A4+	[ICRA]A4+	[ICRA]A4	[ICRA]A4
5	Working Capital Demand Loan	Short-term	(5.00)**	-	[ICRA]A4+	[ICRA]A4+	-	-	-
6	Bank Guarantee	Short-term	(14.75)^	-	[ICRA]A4+	[ICRA]A4+	-	-	-
7	Bank Guarantee	Short-term	(14.75)*	-	[ICRA]A4+	[ICRA]A4+	-	-	-
8	Buyer's Credit	Short-term	(8.00)^	-	[ICRA]A4+	-	-	-	-
9	Buyer's Credit	Short-term	(8.00)*	-	[ICRA]A4+	-	-	-	-
10	Unallocated amount	Long-term and Short-term	4.50	-	[ICRA]BB+ (Negative)/ [ICRA]A4+	[ICRA]BB+ (Stable)/ [ICRA]A4+	[ICRA]BB+ (Stable)/ [ICRA]A4+	[ICRA]BB (Stable)/ [ICRA]A4	[ICRA]BB (Stable)/ [ICRA]A4

*Sublimit of Letter of Credit from Kotak Mahindra Bank

**Sublimit of Cash Credit from Kotak Mahindra Bank

^Sublimit of Letter of Credit from Union Bank of India

^^One way 100% interchangeability from CC to LC from Union Bank of India

Amount in Rs. crore

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

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	08.00	[ICRA]BB+ (Negative)
NA	Cash Credit	-	-	-	08.00^^	[ICRA]BB+ (Negative)
NA	Import/Inland LC	-	-	-	14.75	[ICRA]A4+
NA	Import/Inland LC	-	-	-	14.75	[ICRA]A4+
NA	Working Capital Demand Loan	-	-	-	5.00**	[ICRA]A4+
NA	Bank Guarantee	-	-	-	14.75*	[ICRA]A4+
NA	Bank Guarantee	-	-	-	14.75^	[ICRA]A4+
NA	Buyer's Credit	-	-	-	(8.00)*	[ICRA]A4+
NA	Buyer's Credit	-	-	-	(8.00)^	[ICRA]A4+
NA	Unallocated amount	-	-	-	4.50	[ICRA]BB+ (Negative)/ [ICRA]A4+

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**Sublimit of Cash Credit from Kotak Mahindra Bank

^Sublimit of Letter of Credit from Union Bank of India

^^One way 100% interchangeability from CC to LC from Union Bank of India

Source: S M Steels

Annexure-2: List of entities considered for consolidated analysis- Not applicable

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