

January 21, 2022

SKM Steels Limited: 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	275.00	300.00	[ICRA]BBB+(Positive); reaffirmed
Long Term – Unallocated	15.00	15.00	[ICRA]BBB+(Positive); reaffirmed
Short Term – Fund Based	135.00	110.00	[ICRA] A2; reaffirmed
Short Term – Non-Fund Based	5.00	5.00	[ICRA] A2; reaffirmed
Total	430.00	430.00	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation is based on SKM's continued healthy financial performance, notwithstanding the recent pressure on steel realisations, the revenues are expected to remain higher than the historical average in FY2023. In addition, SKM also proposes to ramp up its presence in the stainless steel (SS) and boiler quality (BQ) plates segment in FY2023, which shall help sustain the revenues.

SKM reported a YoY revenue growth of 60% in H1 FY2022 to Rs. 1,100 crore, led by a 32% YoY improvement in average realisation. The higher revenue along with an efficient management of the receivables strengthened the coverage indicators. Besides, SKM recovered a significant amount of the overdue receivables in H1 FY2022, which led to a sharp decline in the outstanding receivables (for more than 120 days) to Rs. 14.8 crore as on October 31, 2021 (~4% of total receivables) from Rs. 103.8 crore as on June 30, 2020 (accounting for 46% of the total receivables). The ability of the company to maintain its working capital cycle within reasonable levels while sustaining the revenue momentum would be a credit positive. Further, the liquidity position of the company remains adequate, supported by unutilised bank lines of Rs. 215 crore as on September 30, 2021.

The ratings continue to favourably factor in the extensive experience of the promoters in the iron and steel industry, and the company's established relationship with Tata Steel Limited (Tata Steel) as an authorised distributor of its products in Maharashtra, Gujarat, Madhya Pradesh and Goa. Besides, the company has diversified operations with presence in the trading and processing of flat and long products, which reduces dependence on a single sector.

The company remains exposed to the cyclicity associated with the steel industry, which is likely to keep its profits and cash flows volatile. The ratings are also constrained by SKM's thin OPMs due to the limited value-additive nature of its steel processing and trading activities, and the company's exposure to counterparty credit risks in the absence of any credit insurance arrangement.

The Positive outlook reflects ICRA's expectations that SKM Steels Limited's (SKM) credit risk profile will continue to improve over the near term, aided by a favourable operating environment in the steel industry as well as controlled working cycle of operations.

Key rating drivers and their description

Credit strengths

Improved financial profile – SKM's operating performance in YTD FY2022 has remained healthy, supported by strong demand and a sharp rise in steel prices. SKM reported an all-time high revenue of Rs. 1,100 crore in H1 FY2022, led by a 32% YoY

improvement in average realisation. Notwithstanding the recent pressure on steel realisations, the revenues are expected to remain higher than the historical average in FY2023. Further, the revenues are expected to be adequately supported by the robust demand from end-user industries and the stated intent of the management to increase the sales of BQ plates and SS products. ICRA also notes that the stringent credit terms and regular follow-up by the company led to a decline in the overdue receivables (overdue for more than 120 days) to Rs. 14.8 crore as on October 31, 2021, from Rs. 103.8 crore as on June 30, 2020. The decline in receivables along with the increased revenues improved the company's cash flow and financial risk profile, evident in an interest cover of 4.4 times as on September 30, 2021 (vis-à-vis 4.1 as on March 31, 2021, and 1.9 times as on March 31, 2020).

Experience promoters and long association with Tata Steel – SKM commenced steel-processing operations in 1994. The company's promoters have around 50 years of experience in the iron and steel industry. SKM is one of the 26 authorised distributors of Tata Steel in Maharashtra, Madhya Pradesh, Gujarat, and Goa, and has a long business association of about 25 years. The long relationship with Tata Steel ensures a steady supply of flat and long steel products at competitive rates. In FY2021, Tata Steel accounted for 78% of the total procurement by SKM. Tata Steel's products are processed at SKM's Taloja service centre as per the customers' requirements. As SKM is recognised as Tata Steel's external processing unit (EPU), the company is authorised to bid for processing contracts from various Tata Steel clients.

Diversified operations with presence in a wide range of steel products – SKM's portfolio includes cold-rolled close annealed sheets, galvanised plain coils, hot-rolled coils, stainless steel bars, boiler quality plates and thermo-mechanically treated bars. The company caters to the automotive, white goods, construction, engineering, and capital goods industries. The wide product range offered by the company reduces its dependence on a single sector.

Credit challenges

Vulnerability of cash flows to cyclicity in steel sector – SKM is exposed to price risks, given the inherent cyclicity in the steel industry. The price risks are accentuated by the freehold nature of the inventory maintained by the company. However, ICRA notes that the inventory levels maintained by SKM remain low at an absolute level.

Thin profit margins – SKM's OPM remains modest due to limited value addition and the intensely competitive nature of the business. Despite some improvement in FY2021 due to inventory gains, the operating margin is expected to remain in the range of 4-5% in the near to medium term.

Working capital intensive nature of operations – The working capital intensity of operations (net working capital as a percentage of operating income) of SKM remained high at 30.5% as on March 31, 2021. The company is required to make immediate payments to Tata Steel, while a credit period of 45-60 days is offered to its customers. The company also holds an inventory of around one month. In H1 FY2022, the company effectively managed its working capital cycle, reducing the overdue receivables. SKM's ability to sustaining the same while continuing the momentum in revenues would be a credit positive.

Liquidity position: Adequate

The liquidity position of the company is adequate with undrawn fund-based limits of Rs. 151.8 crore vis-à-vis the available drawing power and unutilised channel finance limits (for procurement from Tata Steel) of Rs. 48.3 crore as on September 30, 2021. Additionally, the company had unencumbered fixed deposits of Rs. 1.3 crore as on September 30, 2021. The company has repayment obligations of Rs. 1.2 crore in FY2022 and Rs. 2.4 crore in FY2023 against healthy cash flows of more than Rs. 30 crore. There are no debt-funded capital expenditure (capex) plans in the near to medium term.

Rating sensitivities

Positive factors – The ratings may be upgraded if the company is able to sustain its momentum in revenues and profits and thus the credit metrics while effectively managing its working capital cycle. Specific triggers which will lead to an upgrade include the interest cover improving to above 3.5 times on a sustained basis.

Negative factors – Negative pressure on the ratings could arise if SKM’s revenues and profit margins weaken, affecting the credit metrics and leading to a sustained deterioration in interest coverage to below 2.5 times. Any significant elongation in the receivable cycle/or any major write-off in receivables deteriorating the company’s liquidity position would also be negative factors.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of SKM Steels Limited

About the company

SKM is the flagship company of the SKM Group and is managed by Mr. Chirag Shah and Mr. Amit Shah. It was initially set up as a partnership firm in 1972 and was incorporated as a limited company in 1994. SKM is an authorised distributor of Tata Steel in Maharashtra, Madhya Pradesh, Gujarat, and Goa. The company is also involved in the processing and trading of SS products, trading of structural steel, alloy steel and aluminium flats. It has two processing centres at Taloja, Maharashtra and Indore, Madhya Pradesh.

Key financial indicators

	FY2020 (Audited)	FY2021 (Audited)
Operating Income (Rs. crore)	1,541.5	1,371.2
PAT (Rs. crore)	18.9	37.4
OPBDIT/OI (%)	4.2%	6.4%
PAT/OI (%)	1.2%	2.7%
Total Outside Liabilities/Tangible Net Worth (times)	1.3	1.1
Total Debt/OPBDIT (times)	1.1	0.8
Interest Coverage (times)	1.9	4.1

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 (Rs. crore)	Date & Rating			Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
				21-Jan-2022	06-Jan-2022	01-Apr-2021			
1 Fund Based Limits	Long-Term	300.00	-	[ICRA] BBB+ (Positive)	[ICRA] BBB+ (Positive)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Negative)	[ICRA] BBB+ (Stable)	[ICRA] BBB (Stable)
2 Fund Based Unallocated	Long-Term	15.00	-	[ICRA] BBB+ (Positive)	[ICRA] BBB+ (Positive)	[ICRA] BBB+ (Stable)	[ICRA] BBB+ (Negative)	[ICRA] BBB+ (Stable)	[ICRA] BBB (Stable)
3 Fund Based Limits	Short-Term	110.00	-	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A3+
4 Non-fund Based Limits	Short-Term	5.00	-	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A3+

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term – Fund Based	Simple
Short Term – Fund Based	Simple
Short Term – Non-fund-based	Very Simple
Long Term – Fund Based – Unallocated	Not Applicable

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	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	300.00	[ICRA] BBB+ (Positive)
NA	Unallocated	-	-	-	15.00	[ICRA] BBB+ (Positive)
NA	Channel Financing	-	-	-	110.00	[ICRA] A2
NA	Letter of Credit	-	-	-	5.00	[ICRA] A2

Source: Company

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

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About ICRA Limited:

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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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