

July 06, 2022

SKM Steels Limited: Ratings upgraded to [ICRA]A-(Stable)/[ICRA]A2+; Outlook revised to Stable from Positive

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long term, fund based – Cash Credit	300.0	330.0	[ICRA] A-(Stable); upgraded from [ICRA] BBB+(Positive), outlook revised to Stable
Long term – Unallocated	15.0	-	-
Short term, fund based	110.0	95.0	[ICRA] A2+; upgraded from [ICRA] A2
Short term, non-fund-based	5.0	5.0	[ICRA] A2+; upgraded from [ICRA] A2
Total	430.0	430.0	

*Instrument details are provided in Annexure-1

Rationale

The ratings upgrade favourably factors in SKM Steel Limited's (SKM) improving product mix with increasing share of value-added and specialised steel products such as boiler quality (BQ) plates, galvanised plain (GP) coils and stainless-steel products, resulting in higher blended realisations. The ratings also factor in SKM's improvement in the working capital cycle, led by timely collections and controlled inventory holding period. SKM reported a strong YoY revenue growth of 83% in FY2022 to Rs. 2,511.3 crore, driven by a 38% YoY growth in blended realisation and a 36% YoY growth in sales volumes, led by improved domestic demand. Notwithstanding the expected moderation in steel prices in FY2023, ICRA notes that SKM's focus on specialised steel products is likely to result in higher blended realisations, given the lower price volatility witnessed in these product segments compared to ordinary hot-rolled and cold-rolled coils. This in turn would lend adequate support to its revenues and thus, financial profile over the medium term, with the interest cover expected to sustain over 4-4.5 times. The liquidity position of the company also remains adequate, supported by unutilised bank lines of Rs. 211.1 crore (fund-based limits and channel financing facility) as on March 31, 2022.

The ratings continue to draw comfort from the extensive experience of the promoters in the iron and steel industry and established relationship with Tata Steel Limited (Tata Steel) as an authorised distributor of its products in Maharashtra, Gujarat, Madhya Pradesh, and Goa. The ratings also favourably factor in the diversified customer base of the company with only 16% of the revenues derived from the top five customers. Besides, the company has diversified operations with presence in trading and processing of flat and long products, which in turn reduces dependence on a single sector.

The ratings, however, are constrained by SKM's thin profitability. SKM's operations are also working capital intensive in nature as the company is required to make immediate payments to Tata Steel while it extends a credit period of 60-90 days to its customers. The company also remains exposed to the cyclical nature associated with the steel industry, which is likely to keep its cash flows volatile.

The Stable outlook on the [ICRA]A- rating reflects ICRA's expectations that SKM would continue to benefit from its increasing focus on specialised products, its association with Tata Steel and from the extensive experience of the promoters in the iron and steel industry.

Key rating drivers and their description

Credit strengths

Diversified operations, increasing focus on specialised products – SKM’s portfolio includes cold-rolled close annealed sheets, GP coils, hot-rolled coils, stainless steel bars, BQ plates and thermo-mechanically treated (TMT) 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. Over the last three years, the company has increased its focus on specialised products, share of which has improved to 14% of revenues in FY2022 from 5% in FY2019. This results in higher blended realisation and helps reduce volatility in OPMs. Going forward, the company is expected to continue focusing on increasing the share of value-added products in its sales mix.

Improved financial profile supported by controlled working capital cycle and growth in operations – SKM reported a robust 83% YoY growth in the operating income at Rs. 2,511.3 crore in FY2022 against Rs. 1,371.2 crore in FY2021. This in turn is aided by a 38% YoY growth in sales realisation and a 36% YoY growth in sales volume, driven by improved demand conditions. SKM also improved its working capital cycle through timely collection of receivables and controlled inventory holding period. This led to an improvement in the company’s financial risk profile with an interest cover of 5.6 times in FY2022 vis-à-vis 1.9 times in FY2020. Notwithstanding the expected moderation in steel prices in FY2023, SKM’s focus on specialised steel products is likely to result in higher blended realisations. This in turn would lend adequate support to its revenues and thus, financial profile over the medium term, with the interest cover expected to sustain over 4-4.5 times

Experience of promoters and long association with Tata Steel Limited – 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 FY2022, Tata Steel accounted for 75% 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.

Credit challenges

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 – SKM’s operations are working capital intensive in nature, demonstrated by the net working capital-to-operating income (NWC/OI) of 19-23% over the last four fiscals. The company is required to make immediate payments to Tata Steel while a credit period of 60 to 90 days is offered to its customers. The company holds an inventory of around one month.

Vulnerability of cash flows in steel sector – SKM is exposed to price risks, given the inherent cyclicity in the steel industry. The price risks are accentuated by the largely 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.

Liquidity position: Adequate

The liquidity position of the company is adequate with undrawn fund-based limits of Rs. 136.5 crore vis-à-vis the available drawing power and unutilised channel finance limits (for procurement from Tata Steel) of Rs. 75.1 crore as on March 31, 2022. Additionally, the company had unencumbered fixed deposits of Rs. 22.3 crore as on March 31, 2022. The company has repayment obligations of Rs. 0.6 crore in FY2023 and Rs. 0.7 crore in FY2024 against healthy cash flow from operations. There are no major debt-funded capital expenditure (capex) plans in the near-to-medium term.

Rating Sensitivities

Positive factors – ICRA may upgrade the ratings if the company can significantly increase its operations and profitability, leading to improved liquidity and credit metrics. Specific triggers which may lead to ratings upgrade include the interest cover improving to above 5 times on a sustained basis.

Negative factors – Pressure on the ratings could arise in case of weakening in the revenues and profit margins and thus credit metrics of SKM, leading to a sustained deterioration in the interest cover to below 3.5 times. Any significant elongation in the receivable cycle/or any major write-off in receivables, resulting in deterioration in 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	Standalone

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 also processes and trades in SS products, and only trades in structural steel, alloy steel and aluminium flats. It has two processing centres at Taloja, Maharashtra and Indore, Madhya Pradesh.

Key financial indicators

	FY2021 (A)	FY2022(P)
Operating income (Rs. crore)	1,371.2	2,511.3
PAT (Rs. crore)	37.4	78.4
OPBDIT/OI	6.4%	5.0%
PAT/OI	2.7%	3.1%
Total outside liabilities/Tangible net worth (times)	1.1	1.2
Total debt/OPBDIT (times)	0.9	1.4
Interest coverage (times)	4.1	5.6

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation

Note: Amount in Rs. Crore All calculations are as per ICRA Research

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 (Rs. crore)	Date & rating in FY2023	Date & rating in FY2022				Date & rating in FY2021	Date & rating in FY2020
				Jul 06, 2022	Jan 21, 2022	Jan 06, 2022	Apr 01, 2021	Aug 21, 2020	Jul 12, 2019	
1	Fund based limits	Long term	330.0	-	[ICRA] A-(Stable)	[ICRA] BBB+(Positive)	[ICRA] BBB+(Positive)	[ICRA] BBB+(Stable)	[ICRA] BBB+(Negative)	[ICRA] BBB+(Stable)
2	Fund based, unallocated	Long term	-	-	-	[ICRA] BBB+(Positive)	[ICRA] BBB+(Positive)	[ICRA] BBB+(Stable)	[ICRA] BBB+(Negative)	[ICRA] BBB+(Stable)
3	Fund based limits	Short term	95.0	-	[ICRA] A2+	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2
4	Non-fund-based limits	Short term	5.0	-	[ICRA] A2+	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2	[ICRA] A2

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long Term – Cash Credit	Simple
Short Term – Fund Based	Very Simple
Short Term – Non-Fund-Based	Very Simple

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: www.icra.in

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash Credit	-	-	-	330.0	[ICRA] A- (Stable)
NA	Channel Financing	-	-	-	95.0	[ICRA]A2+
NA	Letter of Credit	-	-	-	5.0	[ICRA]A2+

Source: Company

Annexure II: List of entities considered for consolidated analysis: Not Applicable

ANALYST CONTACTS

Jayanta Roy

+91 33 7150 1100

jayanta@icraindia.com

Priyesh Ruparelia

+91 22 6169 3328

priyesh.ruparelia@icraindia.com

Sakshi Suneja

+91 22 6169 3349

sakshi.suneja@icraindia.com

Sagarikaa Mukherjee

+91 22 6169 3327

sagarikaa.mukherjee@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:

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.

For more information, visit www.icra.in

ICRA Limited



Registered Office

B-710, Statesman House, 148, Barakhamba Road, New Delhi-110001

Tel: +91 11 23357940-45



Branches



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