

August 06, 2019

## Sheel Gems: Rating reaffirmed

### Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based	87.00	87.00	[ICRA]BB(Stable); Reaffirmed
<b>Total</b>	<b>87.00</b>	<b>87.00</b>	

\*Instrument details are provided in Annexure-1

### Rationale

While reaffirming the rating, ICRA has taken a consolidated view of the business and financial profiles of Sheel Gems (SG) and Sheel Diamond Exports Limited (SDEL), owing to the operational synergies shared by these Group entities by being in the same business sector and managed by the same promoters.

The rating reaffirmation favourably factors in the extensive experience of the promoters, the Sheel Group's operating track record of nearly four decades in the cut and polished diamond (CPD) industry, and the established relationships with its geographically-diversified customer base.

However, the rating remains constrained by the Group's weak profitability and moderate debt coverage indicators, and high working capital intensity of operations due to high inventory requirements. The rating also factors in intense competition in the CPD industry, and vulnerability of the Group's profitability to fluctuations in diamond prices and foreign exchange rates. Further, ICRA notes that SG is a partnership firm and any significant withdrawals from the capital account may impact its own and the Group's net worth and capital structure; although, there were no instances of major capital withdrawals over the years, offering some comfort.

### Outlook: Stable

ICRA expects the Sheel Group to continue to benefit from the extensive experience of its promoters in the CPD industry. The outlook may be revised to Positive if healthy growth in profit margins while maintaining the current scale of operations, improvement in capital structure and debt coverage indicators, and a reduction in working capital intensity strengthen the financial risk profile. The outlook may be revised to Negative if lower-than-expected cash accrual, or a stretch in the working capital cycle, weakens liquidity.

### Key rating drivers

#### Credit strengths

**Extensive experience of partners and track record of Group in CPD business** - SG, established in 1980, is a part of the Mumbai-based Sheel Group, which has been in the CPD industry for nearly four decades. The extensive industry experience of the promoters has helped the Group establish strong relationships with customers as well as suppliers.

**Diversified customer base** - The Sheel Group has a diversified customer base spread across domestic as well as export markets of the US, the UAE, Hong Kong, Israel and Belgium. The customer concentration remained moderate with its top five customers driving 42% of the Group's total sales in FY2019. The Group has established strong relationships with many of its customers, as seen by numerous repeat orders from them.

## Credit challenges

**Financial profile characterised by weak profitability and moderate debt coverage indicators** - The Sheel Group's operating profitability historically remained weak, owing to low value addition in the CPD trading business and intense competition in the industry. The operating profit margin (OPM) witnessed a decline in FY2019, at both standalone as well as consolidated levels, due to lower sales and increasing purchase costs of rough diamonds amidst declining sales realisations of polished diamonds. At a standalone level, SG's OPM declined to 2.75% in FY2019 from 3.44% in FY2018, while at the consolidated level, the same declined to 2.44% in FY2019 from 2.56% in FY2018. The net profit margin (NPM) of the firm and the Group historically remained weak (below 2%), owing to low OPM and high interest charges. The Group's debt coverage indicators remained at moderate levels as reflected by interest coverage of 1.22 times, TD/OPBDITA of 4.81 times and NCA/TD of 8% as on March 31, 2019, against interest coverage of 1.30 times, TD/OPBDITA of 8.19 times and NCA/TD of 5% as on March 31, 2018.

**High working capital intensity of operations resulting from high inventory levels** - The Group's working capital intensity historically remained high owing to its elevated inventory levels. The Group's inventory levels generally remain on a higher side and stood at 135 days as on March 31, 2019, given the high lead time involved from procurement to final sale of diamonds. The Group's working capital intensity, though declined to 25% in FY2019 from 33% in FY2018 because of lower debtor days and higher creditor days as on the financial year-end, remained high at an absolute level.

**Intense competition in CPD industry** - The Group faces intense competition from large organised and well-established chains as well as small unorganised players in the industry. This limits its pricing flexibility and bargaining power with customers, thereby putting pressure on its revenues and margins.

**Vulnerability of profitability to fluctuations in diamond prices and forex rates** - The Group's operations remain exposed to the volatilities in rough and polished diamond prices. Any major fluctuations in these key input prices, which cannot be fully passed on to customers, can impact the firm's and the Group's profitability. Given sizeable import purchases, the Group's margins remain susceptible to exchange rate fluctuations. However, the risk is partially mitigated by a natural hedge through exports and use of forward contracts. At the consolidated level, the export sales stood at Rs. 267.28 crore, while the import purchases stood at Rs. 433.99 crore in FY2019.

**Risk of capital withdrawal** - ICRA notes that SG is a partnership firm and any significant withdrawals from the capital account by the partners could impact its own and the Group's net worth and hence, capital structure. Nonetheless, there were no instances of major capital withdrawals over the years, offering some comfort.

## Liquidity position

The Group's fund flows from operations remained positive in FY2019, despite decreased operating income (OI) and increased operating costs. The average monthly utilisation of the sanctioned fund-based pre and post-shipment credit limit stood moderate at 65% at the standalone level and 70% at the consolidate level during the 12-month period ended March 31, 2019. The Group has adequate cushion available in the form of undrawn working capital limits, due to which

ICRA does not foresee any major concerns on liquidity, given absence of capacity expansion plans and minimal term debt repayments of Rs. 0.82 crore in FY2020 and Rs. 0.43 crore in FY2021.

## Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	<a href="#">Corporate Credit Rating Methodology</a> <a href="#">Rating Methodology for Entities in the Indian Gems &amp; Jewellery Industry - Cut &amp; Polished Diamonds</a>
Parent/Group Support	Group company: SDEL Operational support/synergies from SDEL, being in the same line of business
Consolidation/Standalone	Consolidated

## About the company

SG was established as a partnership firm in 1980 by Mr. Chetan Shah and Mr. Bhupendra Mehta to manufacture and process CPDs. It is a part of the Mumbai-based Sheel Group, which has been in the CPD industry for nearly four decades. The Group includes another entity, SDEL, which was incorporated in 1995 by the same promoters and is involved in the same business sector.

At a standalone level, SG reported a profit before tax of Rs. 2.02 crore on an OI of Rs. 269.95 crore in FY2019, compared to a profit after tax of Rs. 2.72 crore on an OI of Rs. 341.67 crore in FY2018.

At the consolidated level, the Sheel Group (SDEL and SG) reported a profit before tax of Rs. 5.05 crore on an OI of Rs. 683.63 crore in FY2019, compared to a profit after tax of Rs. 6.33 crore on an OI of Rs. 700.05 crore in FY2018.

## Key financial indicators (standalone)

	FY2017 (Audited)	FY2018 (Audited)	FY2019 (Provisional)
Operating Income (Rs. crore)	206.42	341.67	269.95
PAT (Rs. crore)	0.96	2.72	2.02*
OPBDIT/OI (%)	2.70%	3.44%	2.75%
RoCE (%)	7.48%	6.69%	6.70%
Total Debt/TNW (times)	1.49	1.46	0.75
Total Debt/OPBDIT (times)	17.25	7.86	6.19
Interest Coverage (times)	1.25	1.56	1.09

\*Profit before tax

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

## Any other information: None

## Rating history for last three years

		Current Rating (FY2020)			Chronology of Rating History for the Past 3 Years		
Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
1 Fund-based Working Capital	Long Term	87.00	-	August 2019 [ICRA]BB(Stable)	September 2018 [ICRA]BB (Stable)	May 2017 [ICRA]BB (Stable)	April 2016 [ICRA]BB (Stable)

## 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-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term Fund-based	NA	NA	NA	87.00	[ICRA]BB(Stable) <i>Source: Sheel Gems</i>

### Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Sheel Diamond Exports Limited	22.50%	Full Consolidation

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