September 29, 2022

Sovereign Metals Limited: Long-term rating upgraded; short-term rating reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	50.00	50.00	[ICRA]BB+ (Stable); Long-term rating upgraded from [ICRA]BB (Stable)
Short-term – Non-Fund based – SBLC	140.00	140.00	[ICRA]A4+; short-term rating reaffirmed
Short-term – Non-Fund based – Forward Cover	-	10.00	[ICRA]A4+; short-term rating assigned
Short-term – Fund based	-	150.00	[ICRA]A4+; short-term rating assigned
Long-term / Short Term – Unallocated	90.00	100.00	[ICRA]BB+ (Stable); upgraded from [ICRA]BB (Stable)/[ICRA]A4+ reaffirmed and assigned for enhanced amount
Total	**280.00**	**450.00**	

**Instrument details are provided in Annexure-1*

Rationale

The upgrade in the long-term rating considers an increase in Sovereign Metals Limited's (SML) scale of operations expected in FY2023, which has witnessed significant growth in the recent years. Additionally, improvement in the company's debt coverage metrics in FY2022 also supports the rating upgrade. The company's scale grew by 34.7% and 17.2% in FY2021 and FY2022, respectively. Further, the debt coverage metrics remained comfortable, as reflected by TD/OPBIDTA of 0.8 times, interest coverage of 3.0 times, TOL/TNW of 1.5 times and DSCR of 3.0 times. The ratings continue to be supported by the extensive experience of the promoters in the gold bullion trading business in India, giving SML access to its network of customers and mitigating customer concentration risk to some extent. ICRA also notes the high refining capacity (100 MT for gold and 250 MT for silver) available with SML, placing it among the top-five domestic gold refiners in terms of capacity. While the capacity utilisation of the refinery remains low as the company is still in the ramp-up phase, an increase in the utilisation will give SML the advantage of economies of scale, which is crucial given the low margin in the business. The company derives significant comfort from the favourable duty differential of 0.65% available for domestic gold refiners and any change in the same will be a key rating sensitivity. The rating further takes into consideration the company's policy to avoid/minimise any gold price and forex fluctuation risks by practising back-to-back order bookings.

The ratings, however, remain constrained by the low value addition in the precious metal refining business, resulting in thin operating margins for the company and strong competition from other gold refineries in India and overseas, accredited with the London Bullion Market Association (LBMA) good delivery. ICRA notes that SML is still in the process of expanding its supplier and customer network, which will be crucial for volume growth. The ratings also consider the significant regulatory risk inherent in the refining business and the fact that any adverse change in the duty structure will result in a threat to the domestic refinery business.

The Stable outlook reflects ICRA's expectations that SML would continue to benefit from the extensive experience of its promoters in the gold trading business and access to their diverse client network, which would drive its sales. ICRA also expects the available duty differential for domestic refiners to continue, supporting SML's profitability.

Key rating drivers and their description

Credit strengths

Extensive experience and track record of promoters in bullion trading business – The Shreeji Group, one of the promoters of SML, has a track record of over 20 years in the gold bullion trading business. SML benefits from the strong system, management, customer/supplier tie-ups and infrastructure support from its promoters. It also has ISO certifications in place as well as a modern laboratory with the latest equipment.

Low working capital intensity – SML requires 2-3 days for refining gold and silver due to which the inventory is very low (5 days). Moreover, all the company's sales are order backed, which enables the company to have low debtor (2 days) and creditor days (3 days). The net working capital intensity of the company stood at 1.5% in FY2022.

Comfortable debt coverage metrics – SML's financial profile has improved significantly in FY2022 on the back of low debt and improved net worth. The same led to comfortable coverage metrics, as reflected by TD/OPBIDTA of 0.8 times (1.6 times in FY2021), interest coverage of 3.0 times (2.3 times in FY2021), TOL/TNW of 1.5 times (2.1 times in 2021) and DSCR of 3.0 times (2.8 times in FY2021).

Credit challenges

Inherently thin margins in gold refining business – The precious metals refining is an inherently low-margin business, given the high absolute value of the products involved and limited value addition. The transactions take place either at a premium or at a discount to the LME gold price, depending on the market conditions and supplier-customer relationships. In addition, there is a duty differential of 0.67% available for domestic refiners, which adds to the margins. The operating margins for established players in the refining business are less than 1%, which implies that SML's build-up in scale would result in increasing profits at an absolute level. Any adverse change in the duty structure, leading to pressure on the profitability, will be a key rating sensitivity.

Strong competition from fine gold importers – A gold refinery in India faces direct competition from banks/financial institutions and traders that directly import fine gold. International refiners that export fine gold to India are generally LBMA Good Delivery accredited, which ensures that the quality of gold meets international standards. SML, however, is not LBMA accredited at present. Hence, the quality of its refined gold is not considered at par with that of imported gold. Thus, it faces stiff competition from imported fine gold and compensates for the perceived lower quality by providing better service and lower rates.

Exposure to regulatory risks associated with refinery business – The available duty differential of 0.65% with respect to imported fine gold gives the domestic refiners enough spread to run profitable operations. However, any reduction in this duty differential through changes in Government policies may erode the margins for SML and significantly impact its operations. Additionally, licence for gold dore import has been made mandatory by the Directorate General of Foreign Trade, Government of India, since June 2018. This licence requires the Bureau of Indian Standards (BIS) to audit the refinery and the refining process. Though SML already has import licence, any issues highlighted by BIS in the future can result in a delay in renewal of the same and thus, significantly impact SML's operations.

Liquidity position: Stretched

SML's liquidity position is stretched considering the limits available with the company against the scale of operations. However, low working capital intensity of the company provides comfort to its liquidity. The company had a sanctioned fund-based working capital facility of Rs. 50.0 crore as on March 31, 2022, the average utilisation of which remained at 62% over the past 12 months. Further, SML has availed a fresh gold loan limit of Rs. 150 crore. The liquidity is also supported by the available unsecured loans from the promoters worth Rs. 10 crore as on March 31, 2022. Also, SML does not have any outstanding long-term loans from banks / financial institutions and hence does not face any repayment pressure.

Rating Sensitivities

Positive factors – A significant ramp-up in capacity utilisation of the refinery, leading to a growth in scale and profitability and a further improvement in the liquidity position on a sustained basis, may lead to ratings upgrade.

Negative factors – Any adverse change in the duty structure, a decline in the expected profit margin or a further stretch in the company's working capital cycle may result in ratings downgrade. Specific credit metrics that could lead to ratings downgrade include an interest coverage above 2.50 times on a sustained basis.

Analytical Approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not Applicable
Consolidation/Standalone	The rating is based on the company's standalone financial profile.

About the company

SML is involved in refining and trading of precious metals like gold and silver. The company was incorporated in February 2012 by the Edelweiss Group, a reputed commodity and security trading house, as Edelweiss Metals Limited. The Edelweiss Group, as a part of its business policy, decided to hive off its non-core commodity business and focus on the core financial services business. Consequently, the company was taken over by the Shreeji Group along with the Lakhi and Mehta families in October 2017 and was renamed as Sovereign Metals Limited. The refinery unit is located at Naroda, Ahmedabad (Gujarat) and has a refining capacity of 100 MT of gold and 250 MT of silver. It is an ISO 9001 and ISO 14001 certified company.

Key financial indicators

SML Standalone	FY2020	FY2021	FY2022#
Operating Income (Rs. crore)	3,520.5	4,741.3	5,558.5
PAT (Rs. crore)	-2.0	3.1	12.2
OPBDITA/OI (%)	0.14%	0.25%	0.43%
PAT/OI (%)	-0.06%	0.06%	0.22%
Total Outside Liabilities/Tangible Net Worth (times)	58.9	2.1	1.5
Total Debt/OPBDITA (times)	19.1	8.0	2.5
Interest Coverage (times)	1.3	2.3	3.0

Source: ICRA Research; PAT: Profit after tax; OPBDITA: Operating Profit before Depreciation, Interest, Taxes and Amortisation; #Provisionals

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 and Rating	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020	
					Sep 29, 2022	Sep 30, 2021	Sep 25, 2020	Jul 23, 2019	May 28, 2019
1	Fund-based – Cash Credit	Long-term	50.00	NA	[ICRA]BB+ (Stable)	[ICRA]BB (Stable)	[ICRA]BB (Stable)	-	-
2	Non-Fund based – SBLC	Short-term	140.00	NA	[ICRA]A4+	[ICRA]A4+	[ICRA]A4+	[ICRA]A4	[ICRA]A4
3	Non-Fund based – Forward Cover	Short-term	10.00	NA	[ICRA]A4+	-	-	-	-
4	Fund based	Short-term	150.00	NA	[ICRA]A4+	-	-	[ICRA]A4	-
5	Unallocated	Long-term / Short Term	100.00	NA	[ICRA]BB+ (Stable)/ [ICRA]A4+	[ICRA]BB (Stable)/ [ICRA]A4+	[ICRA]BB (Stable)/ [ICRA]A4+	-	-
6	Interchangeable limits	Long-term	(0.00)	NA	-	-	-	[ICRA]BB- (Stable)	[ICRA]BB- (Stable)

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based – Cash Credit	Simple
Short-term – Non-Fund based – SBLC	Very Simple
Short-term – Non-Fund based – Forward Cover	Simple
Short-term – Fund based	Simple
Long-term / Short Term – 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 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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term Fund-based – Cash Credit	NA	NA	NA	50.00	[ICRA]BB+(Stable)
NA	Short-term – Non-Fund based – SBLC	NA	NA	NA	140.00	[ICRA]A4+
NA	Short-term – Non-Fund based – Forward Cover	NA	NA	NA	10.00	[ICRA]A4+
NA	Short-term – Fund based	NA	NA	NA	150.00	[ICRA]A4+
NA	Long-term / Short Term – Unallocated	NA	NA	NA	100.00	[ICRA]BB+(Stable)/[ICRA]A4+

Source: *Company*

Please click here to view details of lender-wise facilities by ICRA

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

ANALYST CONTACTS

Jayanta Roy
+91 33 7150 1120
jayanta@icraindia.com

Priyesh Ruparelia
+91 22 6169 3328
.priyesh.ruparelia@icraindia.com

Manish Pathak
+91 124 4545397
manishp@icraindia.com

Raunak Agrawal
+91 8939957111
raunak.agrawal@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

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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

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