February 26, 2024

Star Rays: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/Short-term – Fund-Based – Working Capital Limits	360.00	360.00	[ICRA]A-(Stable)/[ICRA]A2+; reaffirmed
Total	**360.00**	**360.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings continue to draw comfort from Star Rays' (SR) established position in the cut and polished diamond (CPD) industry, extensive domain experience of its promoters of over four decades and presence in the online segment, which gives the firm an easy access to a diversified global market. Besides, the collection risk for the firm is low as a large proportion of its sales is made on a cash basis or with a very low credit period. The firm also benefits from its status as a sightholder of De Beers as well as its association with other diamond mining majors, which facilitate sourcing of rough diamonds at competitive rates and enhances its position in the CPD industry.

In YTD FY2024, the industry continued to face headwinds in the form of global inflationary pressure and unwinding of global liquidity. This, coupled with the firm's policy to deal in remunerative transactions only (due to unfavourable rough-polished diamonds price differential), led to a revenue decline of ~40% in 8M FY2024 (on a standalone level). While higher interest costs and other fixed overhead expenses are expected to moderate coverage indicators such as interest cover in FY2024, these are likely to improve thereafter as the profitability levels improve. This remains a key rating monitorable. Nonetheless, given its controlled working capital cycle, SR has been able to limit its dependence on debt, leading to a comfortable capital structure.

The ratings, however, remain constrained by SR's high inventory holding period, notwithstanding a reduction in absolute inventory levels. The firm also remains exposed to adverse fluctuations in rough diamond prices and stiff competition from the unorganised as well as organised players. The firm's profitability also remains susceptible to the foreign exchange (forex) fluctuation risk due to its export-dominated revenue profile though a natural hedge by the import of rough diamonds and hedging via forward contracts mitigate the risk to a large extent. The ratings remain susceptible to the risk of capital withdrawals, given the partnership constitution of the firm and given the large capital withdrawal in FY2023 towards a retiring partner.

The Stable outlook on the [ICRA]A- rating reflects ICRA's opinion that SR's credit profile is expected to remain comfortable, supported by its prudent working capital management and focus on execution of better gross-margin yielding orders.

Key rating drivers and their description

Credit strengths

Long track record of promoters in the CPD industry – SR is a reasonably large-sized player in the Indian CPD industry with consolidated revenues of Rs. 1,759 crore in FY2023. It is involved in manufacturing and exporting of polished diamonds. The firm's large scale of operations can be attributed to around four decades of promoters' extensive domain experience in the CPD industry and established relationships with its customers and suppliers. Over these years, the firm has developed its core competence in manufacturing high-value CPDs, ranging from thirty cents to ten carats.

Sightholder status with De Beers and sourcing arrangement with other mining companies ensure steady supply of roughs at competitive rates – The CPD industry depends heavily on global miners like De Beers, Alrosa, Rio Tinto, among others, for sourcing of rough diamonds. However, due to stringent qualification requirements of the miners, only a few companies across the globe have direct access to the supplies of roughs from these miners. A steady supply of roughs at competitive rates is important for CPD manufacturers. SR has long-term contracts for procuring fixed quantity from De Beers, and other mining entities. The firm procures 50-60% of its rough requirements from De Beers and other primary suppliers, and it procures the balance from open market/secondary sources. This supports the firm's operations in the form of steady supply of quality roughs at competitive prices.

Comfortable capital structure – The CPD industry faced headwinds in the form of global inflationary pressure, unwinding of global liquidity and slowdown in China due to persistent lockdowns. This, coupled with the firm's policy to deal in remunerative transactions only (due to unfavourable rough-polished diamonds price differential), led to a decline of the consolidated revenues by 26% in FY2023. Nonetheless, given its controlled working capital cycle, SR has been able to limit its dependence on debt, leading to a comfortable capital structure with a gearing at 0.5 times and total outside liabilities vis-à-vis the tangible net worth of 1.1 times as on March 31, 2023 despite sizeable cash withdrawal towards settlement of amount due to a retiring partner. The debt coverage indicators remained satisfactory in FY2023, as reflected in an interest cover of 4.2 times. Its debt coverage indicators would, however, moderate in FY2024 due to a decline in revenues and profits, though the same are expected to improve thereafter as demand conditions improve. The improvement in credit metrics in the medium term on the back of favourable demand conditions would remain a key rating monitorable.

Credit challenges

Demand headwinds being faced by the CPD industry; revenues and profitability also remain exposed to fluctuations in forex rates and rough diamond prices – The CPD industry is facing demand headwinds due to inflationary pressure in key consuming nations. Along with unfavourable rough-polish price differential, this is expected to adversely impact the overall revenues and profitability in FY2024. In 10M FY2024, the overall CPD exports from India contracted by 28% on a YoY basis. Accordingly, SR's revenues and profitability are expected to witness a sharp contraction in FY2024. As a substantial part of the revenues is denominated in foreign currency (primarily in USD), the firm is exposed to adverse fluctuations in the currency markets. However, a natural hedge resulting from the import of rough diamonds provides protection against foreign exchange rate fluctuations to an extent. Additionally, the firm hedges its foreign currency exposure through forward contracts, which mitigate the forex risk. The firm is also exposed to adverse fluctuations in the prices of rough and polished diamonds.

High working capital intensity of operations – The firm's working capital intensity remained high, reflected in net working capital vis-a-vis the operating income (NWC/OI) of 37% as on March 31, 2023 against 31% as on March 31, 2022. While the receivable days remain low as a large proportion of sales is made on cash basis or with a very low credit period, the inventory holding period remains high, which is inherent to the nature of the industry, and leads to high working capital intensity.

Capital withdrawal risk associated with partnership firms – Being a partnership firm, SR is exposed to the capital withdrawal risk. Except for sizable cash withdrawal of Rs. 51.0 crore made in FY2023 towards settlement of amount due to a retiring partner, there have not been substantial cash withdrawals in the recent past. The capital structure continues to remain comfortable, led by steady accretion to reserves despite sizable cash withdrawal.

Liquidity position: Adequate

The firm's liquidity position is adequate, supported by the headroom available in the form of undrawn working capital limits of Rs. 107.0 crore as on December 31, 2023. SR's average utilisation of working capital limits stood at 45% during the 12-month period ended on December 31, 2023 (reflecting an average unutilised limit of Rs. 198 crore during the period with adequate drawing power). While the controlled working capital cycle supported retained cash flows amid a decline in revenues in FY2023, the same is likely to moderate in FY2024 due to a further decline in revenues and profits. SR's debt profile, like most CPD entities, is short term in nature for meeting its working capital requirements. The firm availed emergency credit line guarantee scheme (ECLGS) term loan worth Rs. 15.0 crore in November 2021, which is repayable in five years (Rs. 3.8 crore each year between FY2024 and FY2026 and Rs. 2.5 crore in FY2027). There are no major capital expenditure requirements over the near-to-medium term, which also provides some comfort to its liquidity.

Rating sensitivities

Positive factors – ICRA could upgrade SR's ratings, if there is a sustained improvement in its revenues and profitability along with a reduction in the working capital intensity of operations, leading to an improvement in its financial risk profile.

Negative factors – Pressure on SR's ratings could arise, if there is a deterioration in its earnings or a stretch in the working capital cycle, leading to a moderation in its financial profile and liquidity position. Specific credit metric for a downgrade includes TOL/TNW remaining above 1.5 times, on a sustained basis (at the consolidated level).

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology Rating Methodology – Cut & Polished Diamonds
Parent/Group support	Not Applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of the firm. As on March 31, 2023, the firm had two subsidiaries and four step-down subsidiaries, which are enlisted in Annexure-2.

About the company

Star Rays, incorporated in 1980 as a partnership firm by Mr. Rajendrakumar Shah and Mr. Dilip Mehta, commenced manufacturing of polished diamonds in 1981. Mr. Ramesh Shah and Mr. Jitendra Shah joined the firm in 1985 to help the business grow further. Over the years, it has developed its core competence in the manufacturing of high-value diamonds, ranging from thirty cents to ten carats. The firm procures rough diamonds from primary sources (miners like De Beers, Dominion Diamond and Alrosa, among others) and from the secondary markets in Belgium and Israel, before selling polished diamonds in over 25 countries, including the domestic market. The firm's headquarters and manufacturing facilities are in Surat, Gujarat.

Key financial indicators (audited) - Consolidated

Consolidated	FY2022	FY2023
Operating income	2,365.3	1,759.4
PAT	111.0	60.4
OPBDIT/OI	6.7%	5.7%
PAT/OI	4.7%	3.4%
Total outside liabilities/Tangible net worth (times)	0.8	1.1
Total debt/OPBDIT (times)	1.8	2.2
Interest coverage (times)	11.3	4.2

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. Crore; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation

Key financial indicators (audited) – Standalone

Standalone	FY2022	FY2023
Operating income	2,082.8	1,181.8
PAT	95.2	36.9
OPBDIT/OI	5.3%	5.3%
PAT/OI	4.6%	3.1%
Total outside liabilities/Tangible net worth (times)	0.6	0.8
Total debt/OPBDIT (times)	2.3	3.5
Interest coverage (times)	7.9	2.6

Source: Company, ICRA Research; All ratios as per ICRA's calculations; Amount in Rs. Crore; 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 (FY2024)				Chronology of rating history for the past 3 years		
		Type	Amount rated (Rs. crore)	Amount outstanding as of Dec 31, 2023 (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Feb 26, 2024	Mar 02, 2023	Dec 23, 2021	Sep 04, 2020
1	**Fund-Based – Working Capital Limits**	Long term/Short term	360.00	--	**[ICRA]A- (Stable)/ [ICRA]A2+**	**[ICRA]A- (Stable)/ [ICRA]A2+**	**[ICRA]A- (Stable)/ [ICRA]A2+**	**[ICRA]A- (Negative)/ [ICRA]A2+**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term/Short-term – Fund-Based – Working Capital Limits	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: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	**Fund-Based – Working Capital Limits**	-	-	-	360.00	[ICRA]A- (Stable)/ [ICRA]A2+

Source: Company

Annexure II: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Star Rays	Rated entity (Parent entity)	Full Consolidation
Star Rays Diamonds India Private Limited	Wholly-owned subsidiary	Full Consolidation
Star Solitaire INC	Wholly-owned subsidiary	Full Consolidation
S R Solitaire DMCC	Step-down subsidiary	Full Consolidation
Star Rays Diamond HK Limited	Step-down subsidiary	Full Consolidation
Star Rays Diamonds Botswana Pty Limited	Step-down subsidiary	Full Consolidation
Star Rays Diamonds Namibia Pty Limited	Step-down subsidiary	Full Consolidation

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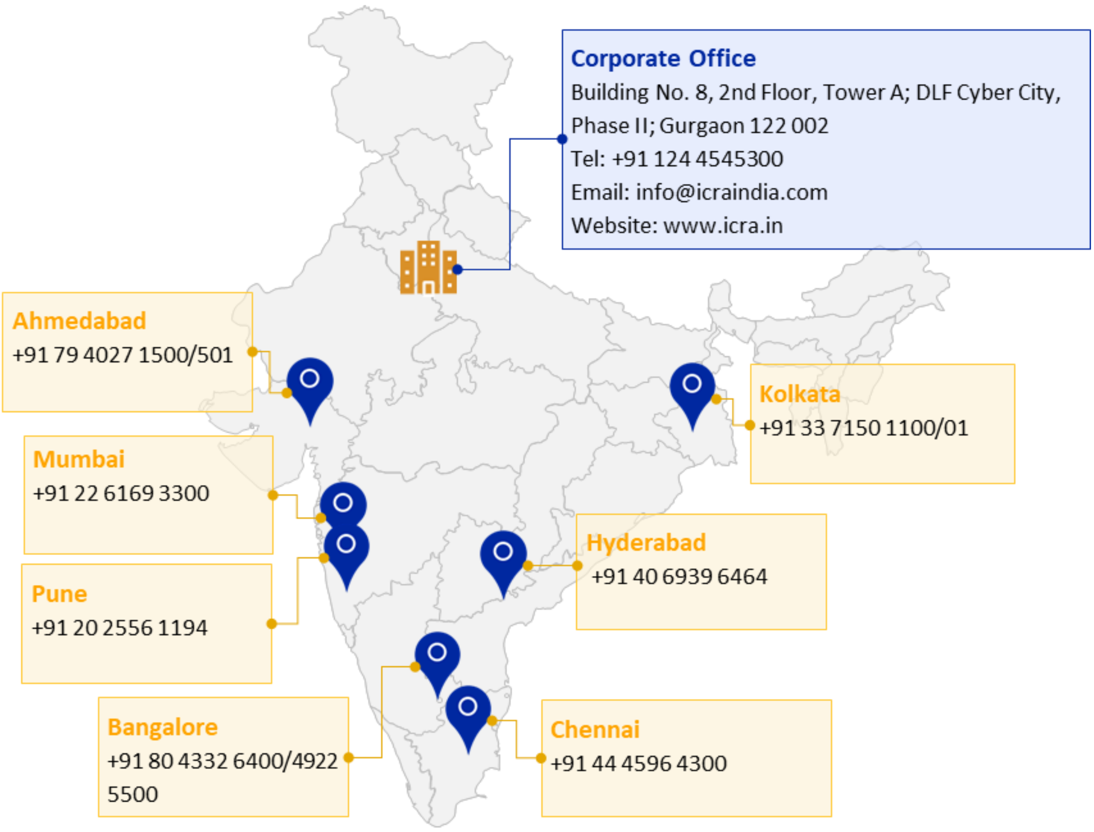

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