

March 18, 2024

## Sanghvi & Sons: Ratings downgraded to [ICRA]BB+ (Stable)/[ICRA]A4+

### Summary of rating action

| Instrument*                                                     | Previous Rated Amount<br>(Rs. crore) | Current Rated Amount<br>(Rs. crore) | Rating Action                                                                    |
|-----------------------------------------------------------------|--------------------------------------|-------------------------------------|----------------------------------------------------------------------------------|
| Long term/Short term, fund based<br>–working capital facilities | 70.00                                | 70.00                               | [ICRA]BB+ (Stable)/[ICRA]A4+;<br>downgraded from [ICRA]BBB-<br>(Stable)/[ICRA]A3 |
| <b>Total</b>                                                    | <b>70.00</b>                         | <b>70.00</b>                        |                                                                                  |

\*Instrument details are provided in Annexure-I

### Rationale

The downgraded ratings factor in Sanghvi & Sons (SS)'s high working capital intensity of operations, which resulted in increased dependency on external debt and, in turn, depressed the coverage metrics in FY2023. The debt coverage indicators are expected to remain subdued in FY2024 as well, driven by elevated interest costs. While the inventory level reduced in FY2024, the same remain high in absolute terms and timely liquidation of the same would be critical.

Additionally, as a net importer, the firm's profit margins are susceptible to foreign exchange fluctuations, although the risk is partially offset by its presence in exports and partial hedging through forward contracts. The profit margins are also exposed to stiff competition from unorganised as well as organised players, resulting in limited pricing power. The ratings also continue to consider the risks associated with SS' status as a partnership concern, wherein any substantial withdrawal from the capital account can adversely impact its capital structure.

The ratings are, however, supported by the extensive domain experience of the firm's partners spanning over three decades, the firm's long track record of operations in the cut and polished diamond (CPD) industry, as well as its established relationships with customers and suppliers. Despite the current global inflationary pressure, which has adversely impacted the demand for discretionary items, including large carat diamonds, the firm reported a steady top line in 8M FY2024 with revenue of Rs. 194 crore in comparison to the same period last year. This is attributable to the firm's increased presence in certain category of diamonds, which yield higher average realisations driven by steady demand. The ratings also take into account adequate buffer from undrawn working capital limits of Rs. 55 crore as on February 29, 2024.

The Stable outlook on the long-term rating reflects ICRA's opinion that SS will continue to sustain its operational performance, led by long-term relationships with its customers and suppliers.

### Key rating drivers and their description

#### Credit strengths

**Experience of partners in the industry** – SS manufactures and trades in CPDs, ranging from one to three carats in different shapes, sizes, and colours. The firm, at present, is managed by three partners — Mr. Mohanlal Sanghvi, Mr. Roshan Sanghvi and Mr. Dhanesh Sanghvi. The partners have an extensive experience of over three decades in this industry.

**Long-term relationships with customers and suppliers** – The firm enjoys established relationships with its customers, including traders and jewellery manufacturers, in the domestic as well as overseas markets. SS' customer base is diversified, with the top-10 customers accounting for 30-40% of the total revenues in the last three years, ending in 8M FY2024. The firm caters to key markets such as Hong Kong, the US, the UAE, and Belgium, among others. Exports accounted for 63% of the total revenues

in 8M FY2024 (as per provisional estimates). The firm enjoys established relationships with diamond auction and tender houses and wholesalers, which ensure uninterrupted supply of rough diamonds.

**Healthy revenue despite demand headwinds faced by the CPD industry** – The CPD industry is facing headwinds due to inflationary pressure in key consuming nations. Along with the unfavourable rough-polished price differential, ICRA expects an adverse impact on the industry's overall revenues and profitability in FY2024. However, the firm reported steady top line in 8M FY2024, with revenue of Rs. 194 crore in comparison to the same period last year due to the firm's decision to increase its presence in certain category of diamonds which yield higher average realisation, driven by steady demand.

## Credit challenges

**Subdued debt coverage indicators** – The firm's credit profile deteriorated in FY2023 with interest cover of 2.2 times in FY2023 (as against 3.5 times in FY2022) and total debt / operating profit of 5.5 times in FY2023 (as against 4.4 times in FY2022). This was largely due to increased dependency on external debt and thin operating profit margin. The debt coverage indicators are expected to remain subdued in FY2024 as well, with interest coverage remaining at 2.0 times, driven by elevated interest costs. The same is 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 monitorable.

**Increased working capital intensity** - The firm's working capital intensity is high, as seen from the high inventory holding period over the last three years. At any given time, the firm holds an inventory of 125 days to 135 days. In FY2023, the firm's net working capital vis-à-vis the operating income (NWC/OI) increased to 48% due to the accumulation of its polished inventory amid the demand slowdown. While the inventory levels have reduced in FY2024, the same remain high in absolute terms and timely liquidation of the same would be critical. The firm extends a credit period of up to 120 days to its customers and receives a credit period of 90-120 days from its suppliers.

**Exposure to foreign exchange fluctuations** - As a net importer, the firm is exposed to risks associated with adverse movements in foreign exchange rates. However, the risk is partially mitigated by the natural hedge from the export of polished diamonds. In addition, the firm partly hedges its exposure through forward contracts. Also, Diamond Dollar Account (DDA, accounting for 15-20% of revenues) sales undertaken by SS, accords protection against foreign currency fluctuations to an extent.

**Risks associated with partnership nature of business** - The firm is exposed to the risk of capital withdrawals by the partners, which could impact its capital structure. Any significant withdrawals may lead to funding gaps and increase the reliance on external borrowings, thereby adversely impacting the capital structure.

## Liquidity position: Adequate

The liquidity position of the firm remains adequate, marked by buffers available from undrawn lines of credit to the tune of Rs. 55 crore as on February 29, 2024. The firm's average working capital utilisation reduced to 51% over the 12 months ending February 2024, compared to 84% average utilisation over the 12 months ending in November 2022. The annual repayment obligations for FY2024-FY2026 are Rs. 3.4 crore each. The firm does not envisage any major capital expenditure requirements over the near-to-medium term, which supports its liquidity.

## Rating sensitivities

**Positive factors** – ICRA could upgrade SS' ratings if the firm demonstrates a consistent growth in revenues and profits. Improved working capital management due to faster turnaround of the inventory along with timely collection of receivables, which materially improves its liquidity profile, would also be a positive trigger.

**Negative factors** – Pressure on SS' ratings could arise if any moderation in the firm's revenues/profitability metrics or a stretch in the working capital cycle or substantial capital withdrawals adversely impacts its financial profile and liquidity position. Weakening in the interest coverage ratio to less than 2.0 times, on a sustained basis, would also trigger a rating downgrade.

## Analytical approach

| Analytical Approach             | Comments                                                                                                                |
|---------------------------------|-------------------------------------------------------------------------------------------------------------------------|
| Applicable rating methodologies | <a href="#">Rating Methodology – Cut &amp; Polished Diamonds</a><br><a href="#">Corporate Credit Rating Methodology</a> |
| Parent/Group support            | Not Applicable                                                                                                          |
| Consolidation/Standalone        | Standalone                                                                                                              |

## About the company

SS was established as a partnership firm in 1981 by Mr. Tarachand Sanghvi and Mr. Mohanlal Sanghvi. The firm is involved in the trading and manufacturing of CPDs. The manufacturing of polished diamonds forms the core business of the firm and accounts for over 95% of its revenues while trading in roughs accounts for the rest. The firm's product profile comprises diamonds ranging from one to three carats. SS sells its products in the domestic as well as international markets through traders, marketing alliances and its web portal. The firm's manufacturing facilities are in Surat and Navsari in Gujarat and its marketing and corporate offices is in Mumbai, Maharashtra.

## Key financial indicators (audited)

|                                                      | FY2022 | FY2023 |
|------------------------------------------------------|--------|--------|
| Operating income                                     | 344.5  | 290.4  |
| PAT                                                  | 6.9    | 4.2    |
| OPBDIT/OI                                            | 4.4%   | 4.5%   |
| PAT/OI                                               | 2.0%   | 1.4%   |
| Total outside liabilities/Tangible net worth (times) | 1.6    | 1.7    |
| Total debt/OPBDIT (times)                            | 4.4    | 5.5    |
| Interest coverage (times)                            | 3.5    | 2.2    |

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

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

## Any other information: None

## Rating history for past three years

| Instrument                                | Type                 | Current rating (FY2024)  |                                                   | Chronology of rating history for the past 3 years |                              |                              |                              |                                |
|-------------------------------------------|----------------------|--------------------------|---------------------------------------------------|---------------------------------------------------|------------------------------|------------------------------|------------------------------|--------------------------------|
|                                           |                      | Amount rated (Rs. crore) | Amount outstanding as of Mar 31, 2023 (Rs. crore) | Date & rating in FY2024                           | Date & rating in FY2023      | Date & rating in FY2022      | Date & rating in FY2021      |                                |
|                                           |                      |                          |                                                   | Mar 18, 2024                                      | Feb 23, 2023                 | Feb 10, 2022                 | Feb 09, 2021                 | July 28, 2020                  |
| 1 Fund based – working capital facilities | Long term/Short term | 70.0                     | --                                                | [ICRA]BB+ (Stable)/[ICRA]A4+                      | [ICRA]BBB- (Stable)/[ICRA]A3 | [ICRA]BBB- (Stable)/[ICRA]A3 | [ICRA]BBB- (Stable)/[ICRA]A3 | [ICRA]BBB- (Negative)/[ICRA]A3 |

## Complexity level of the rated instruments

| Instrument                                                   | Complexity Indicator |
|--------------------------------------------------------------|----------------------|
| Long term/Short term, fund based –working capital facilities | 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   | Long term/Short term, Fund Based – PC /PCFC               | -                | -           | -        | 16.0                     | [ICRA]BB+ (Stable)/[ICRA]A4+ |
| NA   | Long term/Short term, Fund Based – FBP/FCBD/UFBP/PCBP     | -                | -           | -        | 19.0                     | [ICRA]BB+ (Stable)/[ICRA]A4+ |
| NA   | Long term/Short term, Fund Based – Standby Export Limit   | -                | -           | -        | 7.0                      | [ICRA]BB+ (Stable)/[ICRA]A4+ |
| NA   | Long term/Short term, Fund Based – Foreign Bills Discount | -                | -           | -        | 24.0                     | [ICRA]BB+ (Stable)/[ICRA]A4+ |
| NA   | Long term/Short term, Fund Based – Standby Limit          | -                | -           | -        | 4.0                      | [ICRA]BB+ (Stable)/[ICRA]A4+ |

Source: Company

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

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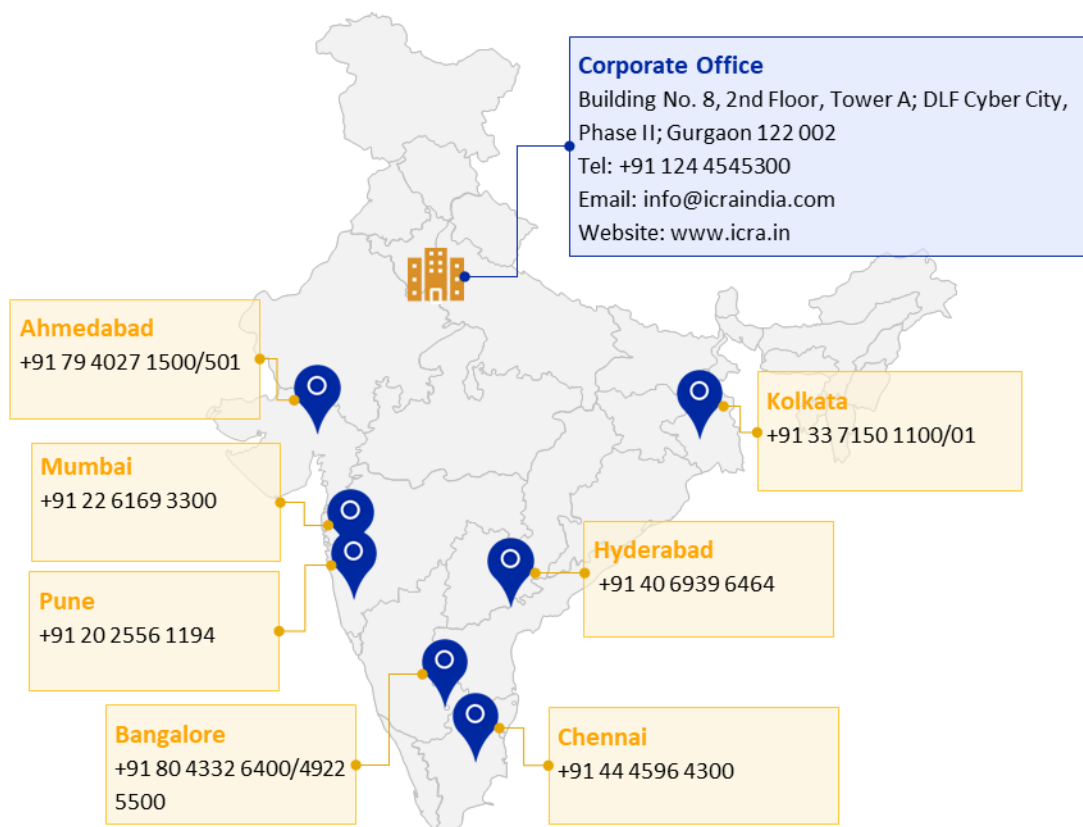


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