July 20, 2020

Senco Gold Limited: Ratings reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund Based – Working Capital Facilities	550.0	625.0	[ICRA]A-(Stable) reaffirmed
Fixed Deposit Programme	115.0	115.0	MA(Stable) reaffirmed
Total	**665.0**	**740.0**	

**Instrument details are provided in Annexure-1*

Rationale

The reaffirmation of ratings considers the stable operational and financial profile of Senco Gold Ltd. (SGL or the company). Despite subdued demand, SGL reported an improvement in earnings in FY2020, led by better gross margins due to rising gold prices against lower procurement costs and rising revenue share of high-margin non-gold jewellery, specially diamond and platinum jewellery. The ratings continue to favourably factor in the vast experience of the promoters in the retailing business of jewellery made of gold, silver, platinum and diamond, long presence and brand recall of SGL in West Bengal and Eastern India and shift of demand towards organised players, supported by greater push for formalisation of the industry.

SGL's operational profile is supported by its rich experience in gold and diamond sourcing and retailing operations, focus on light-weight gold and diamond jewellery, a diversified mix of owned and asset-light franchise operated stores and improving geographical diversification with plans to widen its pan-India presence. SGL's financial profile is characterised by a stable growth in revenues and OPBITDA (with 10% and 25%, CAGR, respectively during FY2016-20), a comfortable return on capital employed (RoCE) of ~18% in FY2020 and moderate debt coverage indicators.

The ratings are, however, constrained by the inherent regulatory risks in the industry, which impacted the retailers' performance in the past, a fragmented industry structure resulting in competitive pricing, and a cautious lending environment. While SGL is also exposed to geographical concentration risks with 70% of revenues coming from West Bengal, the concentration risk has reduced over the years with setting up of stores outside West Bengal in the recent years, with focus on pan-India presence.

While reaffirming the ratings, ICRA notes that in FY2021, SGL's revenue and profitability are expected to be impacted downwards by the Covid-19 pandemic-related shutdown of its stores in April and May 2020, covering the critical Akshaya Tritiya season. Though the company has resumed operations in most of its stores from the end of May 2020, a sharp moderation in demand for gold jewellery is expected because of a reduction in discretionary spending by customers amid the rising gold prices.

The Stable outlook reflects ICRA's expectation that SGL will continue to benefit from the extensive experience of the promoters and established market position of SGL in the jewellery retailing business, particularly in West Bengal. The company's performance would remain sensitive to the duration and breadth of Covid-19 pandemic before an eventual containment. These near-term challenges notwithstanding, the company's ability to maintain its credit profile will be monitored.

Key rating drivers and their description

Credit strengths

Established market presence and strong brand recall in West Bengal and Eastern India – Incorporated in 1994, SGL is managed by Mr. Sankar Sen and Mr. Suvankar Sen. Supported by the promoters' rich experience of over five decades in the gems and jewellery industry and a strong reputation of the 'Senco' brand, SGL commands a dominant market position in gold and diamond jewellery retail business in Eastern India, especially West Bengal.

Strong operational profile – While the jewellery retailing industry in India remains fragmented and SGL faces competition from both organised and unorganised players, SGL's strong brand recall, product quality and creative designs (especially handcrafted jewellery) helped in strengthening its market position. SGL largely caters to the middle-class consumer base, whose preferences have shifted towards the light weight and hand-made jewellery in the recent years. Given its strong design team, ability to identify taste and preferences of consumers, and long association with the skilled artisans, SGL manages to hold competitive edge over its peers.

Healthy financial profile – The company's financial profile is supported by stable return indicators and moderate debt coverage indicators. With steady addition of new stores in the recent years (including nine new stores in FY2020), SGL's operating income grew by 10% (CAGR) during FY2016-20. Increased scale of operations (mostly through asset-light franchise mode), focus on cost control measures, increasing share of non-gold jewellery sales, and higher usage of low-cost gold metal loans (GML) had resulted in a gradual expansion of operating and net margins, up from 4.9% and 1.4% respectively in FY2016 to 9.4% and 3.7% in FY2020. Additionally, SGL's RoCE was comfortable at 18.8% in FY2020, aided by improved operating profits and asset-light store expansion. The capital structure and coverage indicators were moderate with a gearing of 1 times as of end-FY2020 and an interest cover of 3.6 times in FY2020.

While the improvement in operating margins in FY2020 was partly due to a rising share of high-margin jewellery and better gross margins due to rising gold prices against lower procurement costs and partly due to Ind AS accounting treatment. Going forward, however, the margins and debt coverage indicators are expected to moderate in the current year due to the pandemic and weak demand for gold jewellery due to reduction in discretionary spends amid rising gold prices.

Credit challenges

High working capital intensity – Jewellery retailing is highly working capital intensive in nature given the need to display the varied designs of jewellery to its customers. SGL generally maintains an inventory of ~4.5 months, on an average across its stores, depending on the footfall and the stock holding surge during the festive season. The inventory level was particularly elevated (at ~189 days) in end-March-2020 due to 10 days of loss of operations during the year-end and higher valuation of the inventory compared to the last year amid rising gold prices. With a large stockholding requirement, the dependence on working capital loans remains high. Hence, the retailer's ability to improve the operating cycle will be important for improving the working capital intensity and the liquidity profile.

Exposure to geographical concentration risks – At present, SGL has 108 showrooms, out of which around 65% of stores are in West Bengal, which contribute ~70% to its revenues. Thus, the company is primarily a regional player, with presence limited to West Bengal, which exposes it to geographical concentration risks. However, such risk has been gradually reducing over the years and is likely to decline further with the company's plans to add new stores outside West Bengal.

Exposure to regulatory risks – The jewellery retail industry has been witnessing increased regulatory intervention, which impacted the operating environment and consequently the performance of jewellers. Measures like limited access to gold metal loans, mandatory permanent account number disclosure requirement for purchases, limitation on jewellery saving schemes, demonetisation, implementation of the Goods and Service Tax etc., had its effect on both demand and supply in the past. Increasing supervision and the cautious lending environment further restricted fund flows to the sector.

Covid-19 pandemic to impact revenue and profits in FY2021 – SGL remains exposed to the vulnerability of gold jewellery demand to gold price fluctuations and the working capital-intensive operations. In FY2021, SGL could face demand slowdown due to the pandemic-related shutdown of stores, higher gold prices and lower discretionary spending by customers. There was a steep revenue decline in Q1 FY2021 on account of the shutdown of stores, which may constrain margins for the full year, notwithstanding various cost optimisation measures being implemented by the company. Additionally, ICRA takes note of the renewed customer's preference in gold as an asset class and shift from unorganised market to organised market during the Pandemic will pose a good growth opportunity for the company. Nonetheless, ICRA will continue to monitor developments in this regard. Any larger-than-expected contraction in demand stemming from sustained lockdowns will be closely monitored.

Liquidity position: Adequate

SGL's liquidity position is **adequate** with reasonable unencumbered cash and bank balances and negligible long-term debt. While the average working capital utilisation, as a percentage of the sanctioned limits, remained high at ~88% in FY2020, notwithstanding an improvement from ~93% in FY2019. The working capital limits have been enhanced recently and the company has also availed the emergency Covid lines from banks, providing some cushion to its liquidity position. ICRA notes that the company has not availed the deferment of interest option on its working capital as a part of the Covid-19 Regulatory Package announced by the Reserve Bank of India (RBI) on March 27, 2020.

Rating sensitivities

Positive triggers – The ratings could be upgraded if the company is able to significantly increase its sales volumes while maintaining its profitability margins and inventory levels. Also, a significant improvement in the capital structure and debt coverage metrics would be a credit positive.

Negative triggers – The ratings could be downgraded if a substantial increase in the working capital requirements results in elevated levels of debt, leading to a deterioration of the capital structure and debt coverage indicators.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in Gold Jewellery - Retail Industry
Parent/Group Support	Not Applicable
Consolidation/Standalone	The ratings are based on the standalone financial profile of the company.

About the company

Senco Gold Limited was promoted by Mr. Sankar Sen as Senco Gold Private Limited in 1994. It was converted into a public limited company in 2007. The promoters have an experience of over five decades in the jewellery retailing

business. SGL has 56 company operated showrooms and 52 franchise showrooms in West Bengal, Uttar Pradesh, Odisha, Jharkhand, Karnataka, Maharashtra, Assam, Bihar, Delhi, Haryana, Chhattisgarh, Telangana and Tripura.
In FY2020, the company reported a net profit of Rs. 90.8 crore on an operating income of Rs. 2,421.6 crore compared to a net profit of Rs. 74.6 crore on an operating income of Rs. 2,485.5 crore in the previous year.

Key financial indicators (audited)

	FY2019	FY2020
Operating Income* (Rs. Crore)	2,485.5	2,421.6
PAT (Rs. Crore)	74.6	90.8*
OPBDIT/OI (%)	6.8%	9.4%
PAT/OI (%)	3.0%	3.7%
Total Outside Liabilities/Tangible Net Worth (times)	1.5	1.8
Total Debt/OPBDIT (times)	3.3	2.4
Interest Coverage (times)	3.9	3.6

**Operating Income includes Liabilities no longer required written back; PAT is adjusted for prior period expenses*
Source: Company Data

Status of non-cooperation with previous CRA: CRISIL has moved the rating on SGL's fixed deposits to Issuer Not Cooperating category as per its PR dated January 6, 2020. The reason provided was non-furnishing of information for monitoring of ratings.

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2021)				Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Rating	FY2020		FY2019	FY2018
					20-Jul-2020	17-Jul-2019	02-May-2019		
1	Fund-based working capital facilities	Long term	625.0		[ICRA]A- (Stable) reaffirmed	[ICRA]A- (Stable) outstanding	[ICRA]A- (Stable) assigned		
2	Fixed deposits	Medium term	115.0		MA (Stable) reaffirmed	MA (Stable) assigned			

Amount in Rs. crore

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

Annexure-1: Instrument details

ISIN	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund Based Working Capital	NA	NA	NA	625.0	[ICRA]A-(Stable)
NA	Fixed Deposit Programme	NA	NA	-	115.0	MA(Stable)

Source: Senco Gold Limited

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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.

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