KP Sanghvi & Sons LLP

January 31, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating action
Long-term/Short-term, Fund-based limits	1,210.0	800.0	[ICRA]BBB+ (Stable)/[ICRA]A2; outstanding
Total	**1,210.0**	**800.0**	

*Instrument details are provided in Annexure-1

Rationale

The ratings take into account the deterioration in the operating profitability and the continued stretched working capital cycle and weak debt coverage indicators of KP Sanghvi & Sons LLP (KPSS or the firm). The profitability remains constrained by the low value addition in the cut and polished diamond (CPD) business and the same is further hampered by the increased proportion of rough diamond (roughs) trading sales in the past few years. Coupled with rising interest costs, this is expected to further pressurise the firm's interest coverage metrics. The ratings also factor in the firm's relatively leveraged capital structure, as characterised by elevated debt levels, to support the high working capital intensity of its operations.

However, ICRA takes comfort from the firm's established position in the Indian CPD industry, extensive domain experience of the promoters and its professional management set-up. Apart from being a De Beers sightholder, the firm also enjoys supply of rough diamonds from other leading global mining companies such as Alrosa, Rio Tinto and Dominion Diamonds, assuring a steady supply of rough diamonds at competitive rates. Further, the strong net worth of the promoters as well as the demonstrated support in terms of fund infusion by shareholders of other KPSS Group entities, as and when required, also lends support to the firm's consolidated risk profile.

As a major exporter, the revenues of KPSS remain vulnerable to the economic conditions in the key international markets and foreign exchange fluctuations, although the forex risk is mitigated to a great extent by the natural hedge in its rough imports. Additionally, as is typical of most entities in this business, there is a high degree of geographical concentration in terms of KPSS's export revenues, with almost one-third of the revenue contribution, on a standalone level, coming from Hong Kong (also a significant hub for re-export to China, the US and Singapore) and the UAE markets. However, a diversified end-user profile partially mitigates the geographical concentration risks. Nonetheless, the ratings remain sensitive to the risk of capital withdrawals arising out of the limited liability partnership (LLP) nature of the firm. Further, the firm's ability to maintain its profitability and to keep the already high working capital intensity levels under control would also remain key rating sensitivities.

Outlook: Stable

ICRA expects KPSS to continue to benefit from the extensive experience of its partners and the firm's established position in the diamond industry. The outlook may be revised to Positive if substantial growth in revenue and profitability, coupled with better working capital management, strengthen the financial risk profile. On the other hand, the outlook may be revised to Negative if the firm's revenue and profitability witness significant decline due to demand slump and/or adverse price movements of rough and polished diamonds; and if cash accruals are lower than expected, or if any major capital expenditure, or stretch in the working capital cycle, weakens liquidity.

Key rating drivers

Credit strengths

Established market position and extensive experience of the promoters in the CPD industry - Over the past five decades, KPSS has established itself as one of the prominent players in the Indian CPD industry, supported by the extensive experience of its promoters. Coupled with the established relationships with its large clientele and sizeable operating base, this enables the firm to enjoy a competitive position in the industry.

Sightholder status with De Beers and other primary sources lends competitiveness to business operations - The CPD industry depends heavily on global miners like De Beers, Alrosa, and Rio Tinto, among others, for sourcing rough diamonds. However, due to stringent qualification requirements of the miners, only a few companies across the globe have a direct access to the rough supply from them. KPSS features among these top global firms and is a sightholder with De Beers, with access to other primary sources of rough supply as well. This lends significant competitiveness to the firm's operations in a highly competitive and fragmented CPD market.

Financial flexibility arising from liquidity available with promoters - Strong net worth positions of the promoters coupled with adequate liquidity available with the firm and the demonstrated support by shareholders of other KPSS Group entities, also lends support to the firm's consolidated risk profile.

Credit challenges

Financial profile characterised by modest profitability, leveraged capital structure and weak coverage indicators - The CPD industry is highly fragmented and low value addition in the nature of the business, leading to stiff competition. As a result, KPSS's profitability indicators have remained modest and are further impacted by the increasing proportion of rough trading sales, a trend that is expected to continue. Further, the firm's elevated debt levels, to support its stretched working capital cycle have led to a leveraged capital structure, further aggravating the pressure on the debt coverage indicators.

High working capital intensive nature of operations - The firm's working capital intensity remained considerably high in FY2018 (Net Working Capital/Operating Income of ~62% on a standalone basis) due to the inherently elongated working capital cycle of the CPD business, characterised by high receivable and inventory days.

Business operations susceptible to adverse movement in foreign exchange rates – With ~70% of total standalone revenues from export earnings (including deemed exports), KPSS's exposure to foreign currency has remained high over the years, exposing it to the vagaries of the currency markets. However, since the firm's exports are backed by an equivalent amount of imports, the firm enjoys a natural hedge to a large extent. Additionally, the firm also hedges its net foreign currency exposures through forward contracts.

Liquidity Position

Besides the liquidity available with the firm on a consolidated basis, in the form of cash and bank balance, it also enjoys an available cushion of undrawn fund-based working capital limits (average utilisation stood at ~71% in FY2018) on a standalone basis, which are sufficient to fund its modest growth trajectory. Further, the shareholders of other KPSS Group entities have demonstrated their support to the Group's operations in the past by fund infusion, as and when required, in the form of subordinated interest free loans. Considering that the firm's debt profile, like most CPD entities, is short-term in nature for meeting its working capital requirements, KPSS does not have any scheduled debt repayments. Further, as informed by the firm, KPSS does not envisage any major capex requirements over the near-to-medium-term.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Indian Gems & Jewellery Industry – Cut & Polished Diamonds
Parent/Group Support	Not applicable
Consolidation / Standalone	Rating is based on the consolidated financial profile of the firm. As on March 31, 2018, KPSS had two subsidiaries and five step-down subsidiaries (enlisted in **Annexure-2**). However, the consolidated financials have been prepared by the firm only for the purpose of submission of financial information to De Beers in accordance with the applicant guidance notes. Hence, the key financial indicators on a consolidated level are not disclosed in the rationale.

About the company:

KP Sanghvi & Sons LLP, the flagship business establishment of the KP Sanghvi Group, is a partnership firm established in 1965. The firm is recognised as one of the leading manufacturers and exporters of CPDs in the country. The firm has a modern facility at Surat (Gujarat) for manufacturing CPDs. The firm is recognised as a premier trading house by the Government of India. Currently, KP Sanghvi & Sons LLP, is a 'sightholder' of De Beers and also enjoys supply contracts with other miners like Rio Tinto, Alrosa and Dominion Diamonds. The Group also consists of other entities engaged in manufacturing and trading of diamonds and diamond studded jewellery.

Key financial indicators – Standalone (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	1,745.1	1,935.4
PAT (Rs. crore)	25.9	36.5
OPBDIT/OI (%)	5.2%	4.5%
RoCE (%)	6.3%	6.8%
Total Debt/TNW (times)	2.0	1.8
Total Debt/OPBDIT (times)	9.6	9.9
Interest coverage (times)	2.2	2.3

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating January 2019	Date & Rating December 2018	Chronology of Rating History for the Past 3 Years: Date & Rating in FY2018 November 2017	Date & Rating in FY2017 August 2016	Date & Rating in FY2016 August 2015
1	Fund-based limits	Long-term / Short-term	800.0	-	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]BBB+ (Stable)/ [ICRA]A2	[ICRA]A-(Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+	[ICRA]A- (Stable)/ [ICRA]A2+

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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Pre-shipment / Post-shipment credit	NA	NA	NA	800.0	[ICRA]BBB+ (Stable)/ [ICRA]A2

Source: KP Sanghvi & Sons LLP

Annexure-2: List of entities considered for consolidated analysis

Company/Firm Name	Effective ownership	Consolidation Approach
Poonam Exports	100.00%	Full Consolidation
KP Sanghvi Internationale Private Limited	100.00%	Full Consolidation
KP Sanghvi Jewels Private Limited	100.00%	Full Consolidation
KP Sanghvi HK Limited	80.00%	Full Consolidation
KP Sanghvi Inc.	62.03%	Full Consolidation
KP Sanghvi Middle East DMCC	80.00%	Full Consolidation
KP Sanghvi Jewellery BVBA	100.00%	Full Consolidation

Source: KP Sanghvi & Sons LLP

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