

January 06, 2020

R.Rajesh Exports: [ICRA]BB(Stable)/[ICRA]A4 assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Fund Based		
Term Loan	0.33	[ICRA]BB (Stable); assigned
Cash Credit	1.00	[ICRA]BB (Stable); assigned
PC/PCFC	80.00	[ICRA]A4; assigned
Unallocated	19.67	[ICRA]BB (Stable)/ [ICRA]A4; assigned
Total	101.00	

*Instrument details are provided in Annexure-1

Rationale

The assigned ratings favourably factor in the long operational track record of R.Rajesh Exports (RRE), supported by the extensive experience of its partners in the cut and polished diamond (CPD) industry, its established relationships with customers, and strong sourcing arrangements with Diamond Trading Company (DTC) sightholders, which ensure a steady supply of rough diamonds.

The ratings, however, remain constrained by the high working capital intensive nature of the firm's operations, as indicated by net working capital intensity/operating income (NWC/OI) of 36.2% in FY2019, emanating from the high inventory holding. Further, the ratings are constrained by the susceptibility of profitability to the volatility in rough diamond prices as well as foreign exchange fluctuation risks, given the significant export sales of polished diamonds. However, the presence of a natural hedge (import of rough diamonds) and forward contract bookings partly mitigate the forex risk. The ratings further remain constrained by the firm's weak operating margin, inherent in the CPD business, coupled with low debt coverage indicators as indicated by OPBDIT/Interest of 2 times and Total debt/OPBDIT of 7.6 times in FY2019. The ratings are also constrained by the challenging operating environment in the CPD industry, characterised by a persistent slowdown in demand in the key export markets. This has pressurised the firm's sales volume and realisation, as reflected by the fluctuating trend in its operating income (OI) during the last three years. The ratings are further constrained by the competitive intensity in the CPD business with the presence of both organised and unorganised players, and the risk of capital withdrawal inherent in partnership firms, which could have a material impact on the firm's credit quality.

The Stable outlook reflects ICRA's opinion that RRE will continue to benefit from the extensive experience of its promoters in the CPD industry with support from its established sourcing and distribution network.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters in CPD industry – RRE manufactures and exports small-to-large-sized diamonds in the range of 0.1-2 carats. The firm benefits from the vast experience of its promoters along with a professional management setup with extensive experience in the CPD industry.

Established supplier network with sourcing of rough diamonds from DTC players – RRE has an established sourcing arrangement, which ensures the steady supply of roughs at competitive rates. The firm primarily sources roughs from DTC sightholders and directly from DTC auction sales. Moreover, it has a diversified customer base spread across domestic as well as export markets like the US, the UAE, Hong Kong, Israel and Belgium.

Credit challenges

Weak profitability inherent in low value-additive CPD business coupled with weak debt coverage indicators – RRE's operating profitability historically remained weak and steadily declined over the last four years owing to low value addition in the CPD trading business and intense competition in the industry. The operating margin gradually declined to 2.9% in FY2019 from 4% in FY2015. Lower profitability and high borrowing cost resulted in weak coverage indicators as indicated by OPBDITA/Interest of 2.0 times, Total Debt/OPBDITA of 7.6 times and NCA/Debt of 2.2% in FY2019.

High working capital intensity of operations – The firm's working capital intensity of operations has historically remained high with NWC/OI at 36.2% as on March 31, 2019 due to its elevated inventory levels. The inventory levels generally remain on the higher side and stood at 131 days as on March 31, 2019, given the high lead time involved from the procurement to the final sale of diamonds. However, this declined from 173 days as on March 31, 2017 due to higher inventory offtake. The high working capital intensity of operations has entailed the almost full utilisation of working capital limits during the 12 months ending October 2019.

Margins remain susceptible to movements in foreign currency; however, risks offset to an extent by way of natural hedge and forward booking – With a major part of its sales in the form of exports, RRE's margins are susceptible to exchange rate fluctuations. However, the risk is partially mitigated by a natural hedge through imports and forward contract booking. The firm's operations also remain exposed to the volatility in rough diamond prices and the stiff competition in the industry, which affect its pricing flexibility to a large extent.

Risks inherent in a partnership concern including the risk of capital withdrawal by the partners – The firm is exposed to the risk of withdrawal of capital by the partners, which could impact the capital structure. There have been instances of significant withdrawal of capital by the partners in the past.

Stiff competition from organised and unorganised players inherent in CPD industry – RRE faces stiff competition from dominant unorganised players as well as from a few well-established and organised players that are similar in scale and size. This exerts pricing pressure.

Liquidity position – Stretched

The fund flow from operations was positive during the period under study (FY2015-FY2019), supported by an increase in revenues and a reduction in interest expenses. The free cash flow position improved in FY2019 due to an improvement in the receivables position. However, the liquidity position is stretched due to the high inventory holding, which has resulted in near to full utilisation of the working capital limits. The firm has limited buffer on working capital limits with Rs. 2.01 crore undrawn as on March 31, 2019.

Rating sensitivities

Positive triggers – The ratings could be upgraded on an improvement in the scale of operations and profitability along with an interest coverage ratio of more than 2.5 times on a sustained basis and an improvement in the firm's liquidity position.

Negative triggers – Pressure on the ratings would arise in case of a further reduction in the operating margin, resulting in a decline in the interest coverage ratio to less than 1.8 times on a sustained basis, or an elongation in the receivables position or a further stretch in the working capital cycle.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Indian Gems & Jewellery Industry–Cut & Polished Diamonds
Parent/Group Support	Not applicable
Consolidation/Standalone	The ratings are based on the standalone financial statements of the company

About the company

Established in 1985, R.Rajesh Exports (RRE) is a partnership firm and a family-owned business that manufactures cut and polished diamonds. The firm is managed by Mr. Hiren Gajera, Mr. Jadavbhai Sorathia, Mr. Rasikbhai Gajera, Mr. Mahesh Gajera and Mr. Rajesh Sorathia. RRE's diamond manufacturing and processing facility is in Surat (India).

As per the audited statement for FY2019, the company reported a profit after tax (PAT) of Rs. 2.1 crore on an OI of Rs. 356.5 crore compared to PAT of Rs. 2.0 crore on an OI of Rs. 399.2 crore in the previous year.

Key financial indicators

	FY2018FY2019	
Operating Income (Rs. crore)	399.2	356.5
PAT (Rs. crore)	2.0	2.1
OPBDIT/OI (%)	2.9%	2.9%
RoCE (%)	5.9%	5.5%
Total Outside Liabilities/Tangible Net Worth (times)	2.5	1.9
Total Debt/OPBDIT (times)	6.6	7.6
Interest Coverage (times)	1.9	2.0
DSCR	1.5	1.6

Status of non-cooperation with previous CRA

As per CARE's press release dated March 25, 2019, R. Rajesh Export's ratings of CARE BB (Stable) for its Rs. 101-crore bank facilities have been shifted to the issuer not cooperating category, based on best available information.

Any other information: None

Rating history for past three years

Current Rating (FY2020)					Chronology of Rating History for the Past 3 Years		
Instrument	Type	Amount Rated	Amount Outstanding	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017
1	Term Loan	Long Term	0.33	0.33	[ICRA]BB (Stable)	-	-
2	Cash Credit	Long term	1.00	-	[ICRA]BB (Stable)	-	-
3	PC/PCFC	Short Term	80.00		[ICRA]A4	-	-
4	Unallocated	Long Term/Short Term	19.67	-	[ICRA]BB (Stable)/[ICRA]A4	-	-

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	Term Loan	2014	9.5%	2019	0.33	[ICRA]BB (Stable)
NA	Cash Credit				1.00	[ICRA]BB (Stable)
NA	PC/PCFC				80.00	[ICRA]A4
NA	Unallocated				19.67	[ICRA]BB (Stable)/ [ICRA]A4

Source: RRE

Annexure-2: List of entities considered for consolidated analysis – NA

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