April 06, 2020

# Hari Darshan Exports Private Limited: Ratings downgraded to [ICRA]BBB- (Negative)/[ICRA]A3

## Summary of rating action

| Instrument* | Previous Rated Amount (Rs. crore) | Current Rated Amount (Rs. crore) | Rating Action |
|---|---|---|---|
| **Fund-based limits** | | | |
| PSC/EBRD/EPC | 150.00 | 150.00 | [ICRA]BBB- (Negative)/[ICRA]A3; revised from [ICRA]BBB (Stable)/[ICRA]A3+ |
| PC/PCFC | (31.50)^ | (31.50)^ | [ICRA]BBB- (Negative)/[ICRA]A3; revised from [ICRA]BBB (Stable)/[ICRA]A3+ |
| PC/DDA | (90.00)^ | (90.00)^ | [ICRA]BBB- (Negative)/[ICRA]A3; revised from [ICRA]BBB (Stable)/[ICRA]A3+ |
| Direct bills | (90.00)^ | (90.00)^ | [ICRA]BBB- (Negative)/[ICRA]A3; revised from [ICRA]BBB (Stable)/[ICRA]A3+ |
| Associate bills | (14.60)^ | (14.60)^ | [ICRA]BBB- (Negative)/[ICRA]A3; revised from [ICRA]BBB (Stable)/[ICRA]A3+ |
| Cash credit | - | (7.00)^ | [ICRA]BBB- (Negative)/[ICRA]A3; revised from [ICRA]BBB (Stable)/[ICRA]A3+ |
| **Total** | **150.00** | **150.00** | |

**Instrument details are provided in Annexure-1*
*^Sublimit of PSC/EBRD/EPC*

## Rationale

The revision in the ratings and the outlook reflects the YoY degrowth in Hari Darshan Exports Private Limited's (HDEPL) operating income in 9M FY2020 owing to the pressure on the sales volume, resulting from the persistently challenging demand conditions for cut and polished diamond (CPD) players in the key export markets. Furthermore, the rapidly spreading novel coronavirus (COVID-19) pandemic and the reactionary unprecedented lockdown in key export destinations can lead to heightened pressure on the company's revenues and profitability in the near term if the lockdown stretches beyond the anticipated period. Moreover, the company's working capital intensity remains high, as reflected by NWC/OI of 56.3% in 9M FY2020, marked by slow inventory offtake and stretched receivables. The same is expected to deteriorate further due to slow receivables from customers located in geographies affected by the COVID-19 outbreak.

ICRA also takes note of the steady rise in debtors outstanding for more than six months to Rs. 9.5 crore as on March 31, 2019 and Rs. 18.8 crore as on December 31, 2019 compared to Rs. 0.77 crore as on March 31, 2018. The ratings also factor in the continued vulnerability of HDEPL's revenues to the economic conditions in key international markets as it has an export-dominated sales profile. Apart from this, the company's operating profitability levels remained modest in the last three fiscals owing to its limited value addition, which is inherent in the CPD industry, and the intense competition in the CPD business, which limits pricing flexibility, given the presence of organised as well as unorganised players. The interest coverage ratio remained relatively weak at 2.8 times in FY2019 and deteriorated to 2.3 times in 9M FY2020 due to an increase in the utilisation of the working capital limits, resulting in an increase in the finance cost. In addition, the vulnerability of the company's profitability to forex fluctuations remains a concern, given its export-dominated sales profile. The forex risk is partly mitigated by a natural hedge, resulting from the import of rough diamonds, and hedging tools.

The ratings, however, continue to reflect the extensive experience of HDEPL's promoters in the CPD industry, supported by a professional management setup. ICRA notes the company's established relationships with its customers and strong sourcing arrangements with leading miners, given its sightholder status with De Beers and enhanced association with Alrosa. This ensures the uninterrupted supply of rough diamonds at competitive rates. The ratings also take note of the company's recent diversification into the diamond-studded jewellery segment, which will enable it to enter new markets and enhance its geographical reach.

## Key rating drivers and their description

## Credit strengths

**Extensive industry experience of promoters; professional management setup** – HDEPL manufactures and exports small-sized diamonds in the range of 0.001-0.09 carats. The company benefits from the vast experience of its promoters in the diamond industry along with a professional management with extensive experience in the CPD industry. This has helped it establish seven CPD manufacturing units and a jewellery manufacturing unit in Gujarat.

**Sightholder status with De Beers and sourcing arrangement with primary sources ensure steady rough supply at competitive rates** – The CPD industry depends heavily on global miners like De Beers, Alrosa and Rio Tinto for the sourcing of rough diamonds. However, due to stringent qualification requirements, only a few companies across the globe enjoy direct access to the rough supply from these miners. A steady supply of roughs at competitive rates is one of the critical components for CPD manufacturers and the existence of long-term contracts for the procurement of fixed quantities ensures the same. HDEPL became a De Beers sightholder in April 2017, enjoying an advantage over other players with assured supplies without the need to bid for them. The company has also been a sightholder for Alrosa since 2011, which gives it a pricing advantage over other players while ensuring a steady supply of roughs at competitive rates.

**Diversified and large customer base across geographies** – HDEPL's client profile has remained largely diversified because of its established experience in the industry and its diversified product line. The company has cultivated a large customer base from across the world, consisting of wholesalers, retailers, diamond traders, jewellery and watch manufacturers. The customer concentration is moderate with HDEPL's top 10 customers accounting for ~60% of its revenues in FY2019.

## Credit challenges

**Decline in operating income in 9M FY2020 owing to challenging market conditions for CPD players; cascading impact of ongoing pandemic-driven shutdown in key export destinations** – In FY2019, the company had reported a marginal YoY growth rate of ~3% in its operating income, which increased to Rs. 515.4 crore from Rs. 499.8 crore in FY2018. Also, one of the reasons for the sluggish growth was the slowdown in jewellery sales, which stood at Rs. 5.89 crore in FY2019 compared to ~Rs. 25 crore in FY2018. Furthermore, the company's sales witnessed a decline of ~20% in 9M FY2020, falling to Rs. 289.8 crore in 9M FY2020 from Rs. 364.19 crore in 9M FY2019. This was on account of the persistently challenging demand conditions in the key export markets. The challenging demand conditions in the export markets are expected to be amplified by the COVID-19 pandemic outbreak, which has led to temporary lockdowns across various geographies. As the majority of the exports of CPD to China are routed via Hong Kong (a major hub for the Surat diamond industry with ~35% of Indian CPD exports made to Hong Kong and China), the prevalence of COVID-19 is expected to have a negative impact on consumer demand, resulting in a dip in revenues.

**High working capital intensity of operations** – As on December 31, 2019, HDEPL's working capital intensity remained high as indicated by NWC/OI of 56.3% (up from NWC/OI of 34.4% in FY2019). This was on account of high-value inventory holding, slow receivables and the limited credit provided by the suppliers from the primary market. Concerns regarding demand generation due to the fallout from the coronavirus outbreak are expected to create pressure on the inventory movement while collections are expected to be delayed due to the lockdown in China/Hong Kong. This will keep the working capital intensity levels high. As on February 29, 2020, HDEPL's total outstanding debtor position stood at Rs. 123.7 crore, of which Rs. 30.5 crore (24%) was from Hong Kong. The timely recovery of the same without instances of any bill crystallization will remain critical for the company's credit profile.

**Modest profitability indicators prevalent in CPD business and consequently modest interest coverage metrics** – The CPD industry is characterised by a persistent demand slowdown in the key export markets, putting pressure on the sales volume and realisation, owing to YoY changes in the product mix congruent to the demand patterns in the key consuming markets. Although the operating margins have more or less remained stable in the range of 5.7-6.3% in the last three years, the net margins have witnessed a decline due to a reduction in the non-operating income and higher interest expenses following an increase in the LIBOR rates. The modest profitability has resulted in moderate coverage indicators, as reflected by OPBDITA/Interest of 2.8 times in FY2019. In 9M FY2020, the interest coverage deteriorated to 2.3 times due to an increase in the utilisation of the working capital limits, resulting in an increase in the finance cost.

**Margins remain susceptible to foreign currency movements and volatility in rough diamond prices** – A substantial (~70-80%) part of HDEPL's revenues is denominated in foreign currency (primarily the US dollar). Hence, the company is exposed to adverse fluctuations in the currency markets. However, a natural hedge resulting from the import of rough diamonds, packing credit in foreign currency and forward contracts provide protection against exchange rate fluctuations to a large extent.

**Industry characterised by severe competition from unorganised and organised players** – The diamond industry is fragmented, with low value addition and intense competition. HDEPL faces competition from unorganised players as well as from a few well-established organised players, which are fairly large in scale. However, its presence in the diamond industry for almost two decades and its offerings, comprising a variety of products over the years, have made HDEPL develop healthy business relationships with its customers as well as suppliers.

## Liquidity position: Stretched

HDEPL reported positive fund flow from operations in 9M FY2020. However, a decline in the operating income, coupled with high working capital requirements, has stretched the free cash flow position in 9M FY2020. The company's working capital utilisation levels were high with the average working capital utilisation exceeding 85% during the period August 2018 to January 2020. Its liquidity position is **stretched** with an unencumbered cash/bank balance of Rs. 0.35 crore as on December 31, 2019. With a lockdown in most of the consuming markets following the pandemic outbreak, HDEPL has a limited buffer of undrawn working capital limits of Rs. 12.85 crore as on January 31, 2020.

## Rating sensitivities

**Positive triggers** – The outlook will be revised to Stable on the recommencement of business operations, faster collection of payments from customers and higher inventory turnaround.

**Negative triggers** – The ratings may be downgraded in case of a significant decline in revenues, coupled with a decrease in the operating profitability, leading to a deterioration in the coverage indicators. An increase in the working capital cycle due to a further stretch in the receivables or higher inventory holding could also trigger a rating downgrade.

## Analytical approach

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

## About the company

Established in 2003 by Mr. Bhavesh Lakhani and three other partners, Hari Darshan Exports was converted into a private limited company and renamed Hari Darshan Exports Private Limited (HDEPL) in March 2014. The company is involved in the cutting and polishing of rough diamonds. HDEPL has eight manufacturing facilities spread across Gujarat and two offices in Mumbai for assortment, sales and management. Currently, the company has 5,000 employees in eight factories. It also outsources manufacturing to job workers in and around Bhavnagar and Rajkot in Gujarat. HDEPL is an accredited buyer for De Beers and became its sightholder in April 2017.

In FY2019, the company reported a net profit of Rs. 13.0 crore on an operating income (OI) of Rs. 515.4 crore compared to a net profit of Rs. 16.4 crore on an OI of Rs. 499.8 crore in the previous year.

## Key financial indicators

| | FY2018 Audited | FY2019 Audited | 9M FY2020 Provisional |
|---|---|---|---|
| Operating Income (Rs. crore) | 499.8 | 515.4 | 298.5 |
| PAT (Rs. crore) | 16.4 | 13.0 | 4.9 |
| OPBDIT/OI (%) | 5.7% | 6.0% | 6.3% |
| RoCE (%) | 14.4% | 13.3% | 8.6% |
| | | | |
| Total Debt/TNW (times) | 1.4 | 0.9 | 1.1 |
| Total Debt/OPBDIT (times) | 5.1 | 3.3 | 5.4 |
| Interest coverage (times) | 2.4 | 2.8 | 2.3 |
| DSCR | 2.5 | 2.3 | 2.0 |

*Source: HDEPL and ICRA research*

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

## Any other information: None

## Rating history for the past three years

| | | Current Rating (FY2021) | | | | Chronology of Rating History for the Past 3 Years | | |
|---|---|---|---|---|---|---|---|---|
| | Instrument | Type | Amount Rated (Rs. crore) | Amount Outstanding (Rs. crore) | Date & Rating 06-Apr-20 | Date & Rating in FY2020 - | Date & Rating in FY2019 22-Nov-18 | Date & Rating in FY2018 - |
| 1 | PSC/EBRD/EPC | Long term/ Short term | 150.00 | - | [ICRA]BBB- (Negative)/ [ICRA]A3 | | [ICRA]BBB (Stable)/ [ICRA]A3+ | |
| 2 | PC/PCFC | Long term/ Short term | (31.50)^ | - | [ICRA]BBB- (Negative)/ [ICRA]A3 | | [ICRA]BBB (Stable)/ [ICRA]A3+ | |
| 3 | PC/DDA | Long term/ Short term | (90.00)^ | - | [ICRA]BBB- (Negative)/ [ICRA]A3 | | [ICRA]BBB (Stable)/ [ICRA]A3+ | |
| 4 | Direct bills | Long term/ Short term | (90.00)^ | | [ICRA]BBB- (Negative)/ [ICRA]A3 | | [ICRA]BBB (Stable)/ [ICRA]A3+ | |
| 5 | Associate bills | Long term/ Short term | (14.60)^ | | [ICRA]BBB- (Negative)/ [ICRA]A3 | | [ICRA]BBB (Stable)/ [ICRA]A3+ | |
| 6 | Cash credit | Long term/ Short term | (7.00)^ | | [ICRA]BBB- (Negative)/ [ICRA]A3 | | - | |

## 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 | PSC/EBRD/EPC | - | - | - | 150.00 | [ICRA]BBB- (Negative)/ [ICRA]A3 |
| NA | PC/PCFC | - | - | - | (31.50)^ | [ICRA]BBB- (Negative)/ [ICRA]A3 |
| NA | PC/DDA | - | - | - | (90.00)^ | [ICRA]BBB- (Negative)/ [ICRA]A3 |
| NA | Direct bills | - | - | - | (90.00)^ | [ICRA]BBB- (Negative)/ [ICRA]A3 |
| NA | Associate bills | - | - | - | (14.60)^ | [ICRA]BBB- (Negative)/ [ICRA]A3 |
| NA | Cash Credit | - | - | - | (7.00)^ | [ICRA]BBB- (Negative)/ [ICRA]A3 |

*^Sublimit of PSC/EBRD/EPC*
*Source: HDEPL*

## Annexure-2: List of entities considered for consolidated analysis: Not applicable

## Analyst Contacts

K.Ravichandran
+914445964301
ravichandran@icraindia.com

Suprio Banerjee
+91 22 6114 3443
supriob@icraindia.com

Srinivas Menon
+91 22 6169 3354
srinivas.menon@icraindia.com

Vidhi Vasa
+91 22 6169 3352
Vidhi.vasa@icraindia.com

## Relationship Contact

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

## MEDIA AND PUBLIC RELATIONS CONTACT

**Ms. Naznin Prodhani**
Tel: +91 124 4545 860
communications@icraindia.com

## Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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## ICRA Limited


**Corporate Office**
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

**Registered Office**
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

**Branches**

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008,
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 2556 0194/ 6606 9999



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