December 09, 2021

Kanani Industries Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term/short-term: Fund-based	25.00	24.00	[ICRA]B+(Stable)/[ICRA]A4; reaffirmed
Long-term/short-term: Unallocated	-	1.00	[ICRA]B+(Stable)/[ICRA]A4; reaffirmed
Total	**25.00**	**25.00**	

**Instrument details are provided in Annexure-1*

Rationale

The ratings continue to remain constrained by Kanani Industries Limited's (KIL) stagnant revenues and profitability over the past few years, its stretched liquidity position and a moderate financial profile, characterised by its thin operating profit margins (OPM). The ratings also consider the company's high geographical, customer and supplier concentration risks (at a standalone level), vulnerability of its profitability to fluctuations in foreign exchange (forex) rates and prices of polished diamonds, along with intense competition in the industry, which restricts its pricing flexibility.

The ratings, however, favourably factor in the extensive experience of the promoters with more than three decades of experience in the Indian gems and jewellery industry as well as KIL's comfortable capital structure with a gearing of 0.3 times and total outside liabilities vis-à-vis its tangible net worth (TOL/TNW) of 1.3 times as on September 30, 2021 (at the consolidated level).

The Stable outlook on the [ICRA]B+ rating reflects the fact that KIL will continue to benefit from the extensive experience of its promoters and improved demand momentum in the gems and jewellery industry.

Key rating drivers and their description

Credit strengths

Extensive experience of the promoters in gems and jewellery industry – KIL's operations are managed by the Mumbai-based Kanani family, who have vast experience of more than three decades in the gems and jewellery industry. This has enabled the company to establish its position in the market.

Comfortable capital structure – The company's capital structure has remained comfortable over the years with a gearing of 0.3 times and TOL/TNW of 1.3 times as on September 30, 2021, respectively due to the company's modest net worth position and low debt levels.

Credit challenges

High working capital intensity of operations at the standalone level due to stretched receivables – At the standalone level, KIL extends a credit period of 175-180 days to its customers and avails a credit period of 60-90 days from its suppliers, which results in high working capital intensity. The receivable days stood high at 214 in H1 FY2022 (compared to 262 days in FY2021) translating into high working capital intensity with NWC/OI of 41% (compared to 51% in FY2021). The same is also evident from high utilisation of working capital limits.

Moderate financial profile due to thin OPM; stretched liquidity position – While the capital structure of KIL is comfortable due to its modest net worth position, the financial profile continues to remain moderate owing to its thin OPM. Over the years, the revenues remained stagnant in the range of Rs. 300-400 crore. The OPM stood at 0.6% in FY2021 owing to limited value addition. This in turn led to a subdued financial profile, characterised by total debt-to-operating profit ratio (Total Debt/OPBITDA) of 7.7 times as on September 30, 2021 and net cash accruals vis-à-vis the total debt (NCA/TD) of 7% in H1 FY2022. The liquidity position also remains stretched due to low cash generation in the business and stretched receivables cycle (at the standalone level). Going forward, the ability of the company to improve its liquidity position by registering a significant growth in revenues and profitability and efficiently manage its working capital cycle remain key rating sensitivities.

Susceptibility of margins to volatility in raw material prices and forex rates; intense competition in the industry – KIL's OPM remains vulnerable to the fluctuations in prices of diamonds, which in turn affect sales realisations. Any adverse movement in the prices of diamonds could impact its profitability, considering its limited ability to pass on the price hike owing to intense competition in the industry. Given the sizeable exports, the company's profitability remains exposed to fluctuations in forex rates. However, a natural hedge in the form of import of polished diamond mitigates the forex risk to a large extent. The studded jewellery industry is highly fragmented and is characterised by intense competition. KIL not only faces stiff competition from dominant unorganised players, but also from well-established organised players.

High geographical, customer and supplier concentration at the standalone level – At the standalone level, KIL exports primarily to Hong Kong and the top-5 customers account for 100% of the total revenues, which exposes it to geographical and customer concentration risks. KIL's supplier concentration also remains high as it procures polished diamonds from a single supplier based out of Hong Kong. Nevertheless, KIL's established relationship with the customers and suppliers ensures repeat orders and uninterrupted supply, which mitigate the risks to an extent.

Liquidity position: Stretched

KIL's liquidity remains **stretched** due to its modest cash flows on the back of thin profit margins and stretched receivables. The average utilisation of the working capital limit stood at 89% during the 18-month period ended in September 2021. KIL does not have any term loan repayment obligations and there are no capital expenditure (capex) plans. The company's free cash and bank balances stood at a modest level of Rs. 0.9 crore as on September 30, 2021.

Rating sensitivities

Positive factors – The ratings may be upgraded if the company is able to improve its liquidity position and significantly increase its scale of operations and profitability on a sustained basis.

Negative factors – The ratings may be downgraded if the company's revenues and/or profitability decline on a sustained basis, leading to a deterioration in the financial risk profile or if a stretch in the working capital cycle impacts its liquidity position.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of Kanani Industries Limited, which includes the financials of its wholly-owned subsidiary, KIL International Limited (based out of Hong Kong). The entities considered for consolidation are enlisted in Annexure 2.

About the company

KIL was originally incorporated as Shivlaxmi Mercantile Company Limited on March 22, 1983 and was listed on the Bombay Stock Exchange (BSE) on May 16, 1984. It began manufacturing diamond-studded silver jewellery from January 2008 with exports to Hong Kong. To further increase its presence in the Hong Kong market, KIL had set up a 100% wholly-owned subsidiary, KIL International Limited, which began operations from July 4, 2011 by trading in diamonds and jewellery.

Key financial indicators (Consolidated)

	FY2020 (Audited)	FY2021 (Audited)	H1 FY2022 (Reported)
Operating Income (Rs. crore)	377.2	312.5	175.1
PAT (Rs. crore)	2.6	0.4	0.7
OPBDIT/OI (%)	1.0%	0.6%	0.7%
PAT/OI (%)	0.7%	0.1%	0.4%
Total Outside Liabilities/Tangible Net Worth (times)	1.7	1.4	1.3
Total Debt/OPBDIT (times)	6.4	11.8	7.7
Interest Coverage (times)	3.7	1.5	2.5

PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
Source: Company, ICRA research; All ratios as per ICRA calculations

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2022)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2021	Date & Rating in FY2020	Date & Rating in FY2019
					09-Dec-2021	08-Oct-2020	16-Jan-2020	27-Dec-2018
1	Fund-based	Long-term / short-term	24.00	-	[ICRA]B+ (Stable)/ [ICRA]A4	[ICRA]B+ (Stable)/ [ICRA]A4	[ICRA]B+ (Stable)/ [ICRA]A4	[ICRA]A4
2	Unallocated	Long-term / short-term	1.00	-	[ICRA]B+ (Stable)/ [ICRA]A4	-	-	-

Complexity level of the rated instrument

Instrument	Complexity Indicator
Long-term/short-term: Fund-based	Simple
Long-term/short-term: Unallocated	Not Applicable

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, is available on ICRA’s 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	Long-term/short-term: Fund-based	-	-	-	24.00	[ICRA]B+(Stable)/[ICRA]A4
NA	Long-term/short-term: Unallocated	-	-	-	1.00	[ICRA]B+(Stable)/[ICRA]A4

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis

Sr.	Company Name	Consolidation Approach
1	Kanani Industries Limited	Full consolidation
2	KIL International Limited	Full consolidation

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