June 25, 2020

Creations Jewellery Manufacturing Private Limited: Rating reaffirmed; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Pre-Shipment Credit - EPC/PCFC	20.00	20.00	[ICRA]BBB/[ICRA]A3+; reaffirmed Outlook revised to Stable from Positive
Post-Shipment Credit - EBR	25.00	25.00	[ICRA]BBB/[ICRA]A3+; reaffirmed Outlook revised to Stable from Positive
Standby Line of Credit	9.00	9.00	[ICRA]BBB/[ICRA]A3+; reaffirmed Outlook revised to Stable from Positive
Unallocated Limits	0.50	0.50	[ICRA]BBB/[ICRA]A3+; reaffirmed Outlook revised to Stable from Positive
Total	**54.50**	**54.50**	

**Instrument details are provided in Annexure 1*

Rationale

While arriving at the rating, ICRA has considered the consolidated financial statements of the Group which includes Creations Jewellery Manufacturing Private Limited (CJMPL) and its wholly owned subsidiary, Cynergy Trading Corporation (CTC).

The revision in outlook reflects the challenging business environment for the gems and jewellery sector due to the global Covid-19 pandemic, with ongoing lockdowns across geographies, contagion fears, restricted movements and consequent economic uncertainties, all of which are expected to impact the operations and cash flows of CJMPL in the current fiscal. The extent of the impact on revenues and earnings would, however, depend on the eventual duration of the pandemic related demand fallout. The rating continues to remain constrained by the Group's high working capital intensity of operations emanating from its high inventory holding; although its working capital funding is largely met through internal accruals with low reliance on external debt. The rating also remains constrained by the susceptibility of the Group's revenues and profitability to adverse movements in the prices of gold as well as rough and polished diamonds, coupled with the vulnerability to movements in the foreign exchange rates. However, these risks are partly offsets by the order-backed procurement, natural hedging by way of imports and hedging through forward contracts. The rating, moreover, considers the Group's exposure to intense competition in the highly fragmented gems and jewellery industry, which limits pricing flexibility.

The rating reaffirmation, however, favourably factors in the Group’s association with a large multinational retail chain, which has supported its growth in revenues in FY2020 to ~Rs. 241 crore against Rs. 170.8 crore in FY2019 on a standalone basis. Further, favourable changes in product mix with greater share of higher margin commanding product in the total sales revenue have resulted in improvement in operating margin at standalone as well as the Group level in FY2019. However, ICRA expects some moderation in the Group’s operating margin in FY2020, given its limited bargaining power with its recently onboarded large multinational customer and a further moderation in the current fiscal, given the low absorption of fixed cost amid decline in revenues. Despite this, the controlled debt level in the current fiscal and the Group’s debt-free status along with moderate operating profitability, has resulted in comfortable capital structure and strong coverage indicators. Evidently the interest coverage remains robust at 13.3 times on a standalone level and 17.0

times at a consolidated level in FY2019. The rating also draws comfort from the presence of sizable free cash at the Group level, which renders support to its liquidity profile as on March 31, 2019.

The rating continues to consider the extensive experience of the promoters in the gems and jewellery industry, supported by a professional management team and its established relationships with customers as well as suppliers. The rating also continues to favourably factor in the various fiscal benefits and duty exemptions entitled to CJMPL for being in a special economic zone (SEZ), which renders support to its profitability to some extent.

Going forward, the Group's ability to ramp up the scale of operations by securing regular orders from its newly onboarded customers will be a rating sensitivity. Improvement in operating margin amid volatilities in input prices and foreign exchange fluctuations as well as faster inventory turnaround that reduces its working capital intensity will also constitute key rating sensitivity factors.

Key rating drivers and their description

Credit strengths

Extensive experience of promoters with established track record in gems and jewellery industry – CJMPL was incorporated in 2001. The promoters have an extensive experience of over 25 years in the gems and jewellery industry, which has facilitated the company to establish strong relationships with customers as well as suppliers.

Fiscal benefits from location in SEZ - CJMPL's manufacturing facilities are located at Santa Cruz Electronics Processing Zone (SEEPZ Mumbai), an export promotion zone, where the company enjoys higher tax benefits (exemption from income tax, GST and custom duty under the Income Tax Act, 1961). It also enjoys faster custom clearances and easy availability of inputs at competitive prices.

Onboarding multinational retail chains to client base render support to the revenue growth in the business - In FY2020, CJMPL onboarded one of the largest multinational retail chains to its customer list, which contributed ~Rs. 50-60 crore to revenues in 8M FY2020 (~30%). CJMPL recorded revenues of ~Rs. 241 crore in FY2020 against Rs. 170.8 crore in FY2019 on a standalone basis, following an increase in sales off-take, mainly by the multinational retailer. Nevertheless, the margins are likely to be impacted to a certain extent by low margin yielding products as well as limited bargaining power against the retail giant.

Comfortable financial risk profile - Over the past several years, the Group has maintained strong credit metrics, aided by healthy cash flow generation and low reliance on outside debt. The Group's debt-free status along with moderate operating profitability has resulted in comfortable capital structure and strong coverage indicators as reflected by OPBDIT/Interest at 17.0 times in FY2019.

Credit challenges

Challenging business environment due to ongoing global pandemic, along with discretionary consumer spending likely to impact revenues in near term – The Group's sales, profitability and cash accruals are closely linked to macro-economic conditions, consumer confidence and spending patterns, particularly considering the discretionary nature of its products. In addition, given the expected adverse impact of the Covid-19 pandemic on the gems and jewellery industry, ICRA expects the Group's operating performance to remain under pressure in the coming months because of the prevalent weak demand conditions and potential change in consumer behaviour towards visiting public places, although online sales through the retailer will mitigate the risk to a certain extent. Hence, while the key consuming markets are anticipated to reopen gradually in the coming days across most locations, demand recovery is likely to take longer, given that discretionary consumer spending is expected to remain at a relatively lower level than the preceding fiscal.

Consequently, the Group's sales are expected to be lower in Q1 FY2021 over the previous year, given the continuing lockdown in key consuming markets with limited online presence.

Profitability susceptible to demand from key consuming markets, fluctuations in raw material prices and forex rates - The rates of gold and diamond fluctuate on a YoY basis, which exposes the company's profitability to price fluctuation risks, given its high inventory levels. Moreover, being an export-oriented unit, margins are also vulnerable to currency fluctuations. However, the risk is mitigated to a large extent since most of its key raw materials like diamond and gold, although procured locally, are dollar denominated (deemed imports). Further, the company also enters into forward contracts to hedge the risk against a fluctuating currency market.

Working capital intensive nature of operations due to high inventory holding – The Group's operations are working capital intensive in nature as it maintains an inventory level of about 5-6 months consisting of various types of products manufactured, thus exposing itself to the risk of inventory losses. However, despite the high working capital intensity at a consolidated level with NWC/OI of 45%, the Group has resorted to minimal utilisation of its working capital limits due to healthy cash accruals and improving profitability levels in FY2019.

Intense competition on account of fragmented industry structure - The gems and jewellery manufacturing industry is highly fragmented and characterised by intense competition from unorganised players as well as a few well-established organised players. During the last decade, the diamond jewellery manufacturing industry has become more competitive with several new players and retailers preferring to maintain a wider variety of designs to suit customer requirements. This has resulted in increasing competition and lowering sales growth with retailers broadening their vendor bases to maintain a wider portfolio of designs for customers.

Liquidity position: Adequate

The Group was debt-free as on March 31, 2019. Further, the fund flow from operations (FFO) continued to remain healthy due to adequate profitability, healthy cash accruals and efficient working capital management, which translated to positive free cash flows. ICRA assesses the Group's liquidity position as **adequate**. The same was supported by undrawn working capital limits of Rs. 54 crore as on March 31, 2020, against which the company has maintained fixed deposits with the bank.

Rating sensitivities

Positive triggers – ICRA could upgrade CJMPL's rating if the company demonstrates a significant improvement in its scale of operations, coupled with better accumulation of profits at an absolute level, on a sustained basis. In addition to better management of inventory turnaround, this could trigger a rating upgrade.

Negative triggers – Higher than anticipated decline in sales and margin, or any significant stretch in inventory holding, or delay in receivables worsening the working capital cycle and liquidity position of the company, could result in a rating downgrade.

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 rating is based on the consolidated financial profile of the Group

About the company

Incorporated in 2001, Creations Jewellery Manufacturing Private Limited manufactures and exports diamond-studded gold and silver jewellery. The company is managed by Mr. Adil Kotwal and Mr. Cyrus Kotwal. CJMPL is a 100% export oriented unit with two manufacturing units at SEEPZ in Andheri, Mumbai. The company also has an administrative office at Bandra Kurla Complex, Mumbai.

CJMPL has a wholly owned subsidiary, Cynergy Trading Corporation, in USA (together referred to as the Group), which is engaged in the marketing and distribution of jewellery. CTC procures its requirements mainly from CJMPL.

At a standalone level, in FY2019, the company reported a profit after tax (PAT) of Rs. 10.6 crore on an OI of Rs. 170.8 crore, compared to a net PAT of Rs. 7.1 crore on an OI of Rs. 168.7 crore in the previous year.

At a consolidated level, in FY2019, the company reported a profit after tax (PAT) of Rs. 13.7 crore on an OI of Rs. 193.5 crore, compared to a net PAT of Rs. 9.6 crore on an OI of Rs. 186 crore in the previous year.

Key financial indicators

	Standalone			Consolidated	
	FY2018 Audited	**FY2019 Audited**	**8MFY2020 Provisional**	**FY2018 Audited**	**FY2019 Audited**
Operating Income (Rs. crore)	168.7	170.8	179.8	186.0	193.5
PAT (Rs. crore)	7.1	10.6	11.8	9.6	13.7
OPBDIT/ OI (%)	5.5%	7.9%	6.4%	7.3%	8.9%
RoCE (%)	7.4%	10.5%	14.0%	9.3%	12.5%
Total Outside Liabilities/Tangible Net Worth (times)	0.4	0.3	0.2	0.2	0.1
Total Debt/OPBDIT (times)	1.1	0.0	0.2	0.8	0.0
Interest Coverage (times)	5.5	13.3	12.3	8.0	17.0
DSCR	5.5	11.8	14.3	7.1	14.9

Source: CJMPL

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Current Rating (FY2021)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	Date & Rating 25-Jun-20	Date & Rating in FY2020 06-Jan 2020	Date & Rating in FY2019 31-Dec 2018	Date & Rating in FY2018 28-Sep-2017
1	Pre-Shipment Credit – EPC/PCFC	Long term/Short term	20.00		[ICRA]BBB (Stable)/A3+	[ICRA]BBB (Positive)/A3+	[ICRA]BBB (Stable)/A3+	[ICRA]BBB (Stable)/A3+
2	Post Shipment Credit – EBR	Long term/Short term	25.00		[ICRA]BBB (Stable)/A3+	[ICRA]BBB (Positive)/A3+	[ICRA]BBB (Stable)/A3+	[ICRA]BBB (Stable)/A3+
3	Standby Line of Credit	Long term/Short term	9.00		[ICRA]BBB (Stable)/A3+	[ICRA]BBB (Positive)/A3+	[ICRA]BBB (Stable)/A3+	[ICRA]BBB (Stable)/A3+
4	Unallocated	Long term/Short term	0.50		[ICRA]BBB (Stable)/A3+	[ICRA]BBB (Positive)/A3+	[ICRA]BBB (Stable)/A3+	-

All figures 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 No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Pre-Shipment Credit – EPC/PCFC	-	-	-	20.00	[ICRA]BBB(Stable)/ [ICRA]A3+
NA	Post Shipment Credit – EBR	-	-	-	25.00	[ICRA]BBB(Stable)/ [ICRA]A3+
NA	Standby Line of Credit	-	-	-	9.00	[ICRA]BBB(Stable)/ [ICRA]A3+
NA	Unallocated	-	-	-	0.50	[ICRA]BBB(Stable)/ [ICRA]A3+

Source: CJMPL

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Creations Jewellery Manufacturing Private Limited	-	Full Consolidation
Cynergy Trading Corporation	100%	Full Consolidation

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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.

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For more information, visit www.icra.in

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