

October 08, 2020

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 | 25.00 | [ICRA]B+ (Stable)/ [ICRA]A4; reaffirmed |
| Total | 25.00 | 25.00 | |

*Instrument details are provided in Annexure-1

Rationale

The reaffirmation of ratings continues to be constrained by Kanani Industries Limited's (KIL) stagnant operating income (OI) and thin profitability over the last five fiscals. ICRA also notes that the Covid-19 pandemic and the reactionary, unprecedented lockdown in key consuming markets can lead to pressure on the entity's revenues and profitability in the near term, which will be a key monitorable. The ratings also take into account the company's high working capital intensive nature of operations (as indicated by net working capital (NWC)/OI of 49% in FY2020) emanating from stretched receivables, with debtor days at 223 in FY2020. ICRA further notes the exposure of KIL's operations to high supplier concentration risk with purchases being done entirely from a single supplier in FY2020. Further, ICRA considers the susceptibility of the company's profitability to adverse fluctuations in key raw material prices and foreign exchange rates. Intense competition in the jewellery industry further restricts KIL's pricing flexibility.

The rating, however, favourably factors in the extensive experience of the promoters with more than 35 years of experience in the diamond industry as well as KIL's comfortable capital structure with a gearing of 0.59 time as on March 31, 2020.

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

Key rating drivers and their description

Credit strengths

Established experience of the promoters in the diamond industry - KIL's operations are managed by the Mumbai-based Kanani family, who have vast experience of more than three decades in the diamond industry. The same 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 gearing of 0.59 time as on March 31, 2020, supported by a net worth position that stood at Rs 42.69 crore as on March 31, 2020.

Credit challenges

Stagnant revenues and thin profitability over the past five years - The company's revenues have remained stagnant with revenues in the range of Rs. 81–86 crore over the past five years. KIL registered a marginal YoY growth of 3.8% in its

operating income in FY2020, which increased to Rs. 86.29 crore from Rs. 83.14 crore in FY2019. The company's financial profile is also characterised by thin profitability as reflected by its modest operating margins at 2.14% and subdued net profit margins (NPM) at 0.66% in FY2020. Due to the lockdown induced by the ongoing pandemic and the ensuing challenging business environment, ICRA expects the firm's revenue and profitability to be impacted in FY2021. However, since the company trades in low priced diamond studded silver jewellery, demand has not been severely impacted as reflected by operating income (OI) of Rs. 17.22 crore registered in Q1 FY2021 (4% growth over Q4 FY2020 revenues and -27% revenue degrowth over Q1 FY2020).

High working capital intensity of operations due to stretched receivables - The company provides a credit period of 180 days to its customers and avails a credit period of 30 to 60 days from its suppliers. The company's debtor days remained high at 223 days in FY2020 (208 in FY2019) translating into high working capital intensity with NWC/OI at 49%. This has also led to consistently high utilisation of working capital limits.

Supplier base remains concentrated in FY2020 - Polished diamonds are the company's primary raw material, procured mainly through imports while silver is purchased from the domestic market. The company's supplier concentration risk remained high in FY2020 with the entire purchase of polished diamonds being made from a single supplier, based out of Hong Kong. Nevertheless, KIL's established relationship with the supplier mitigates the risk to an extent.

Susceptibility of margins to volatility in raw material prices and forex rates- Since polished diamonds are the primary raw materials for KIL, its profitability remains vulnerable to the variations in polished diamond prices. Further, KIL has an inherent forex fluctuation risk due to its export-dominated sales profile and the absence of any hedging mechanisms.

Intense competition from unorganised and organised players - The studded jewellery industry is highly fragmented and characterised by intense competition. KIL not only faces stiff competition from dominant unorganised players, but also from well-established organised players.

Liquidity position: Stretched

KIL's liquidity profile is stretched owing to high working capital intensity and low cash accruals. KIL had a modest free cash balance of Rs. 0.08 crore as on March 31, 2020 and minimal undrawn working capital limit buffer of Rs. 0.89 crore as on August 31, 2020, with an average working capital utilisation of its fund-based bank limits at 96% during the 9-month period ended August 2020. Although the company does not have any capex plans in the medium term and no external long-term borrowings on its books, ICRA foresees concerns on liquidity given the stretched receivables, low cash accruals and limited cushion available in the form of undrawn working capital limits.

Rating sensitivities

Positive triggers - The ratings may be upgraded if the firm registers an increase in scale of operations and profitability on a sustained basis, coupled with efficient management of its receivables cycle.

Negative triggers - The ratings may be downgraded if the firm's scale of operations and profitability decline on a sustained basis, and if there is any further stretch in its receivables cycle. Any support to Group companies, materially impacting the liquidity profile of KIL, will also be a negative rating trigger.

Analytical approach

| Analytical Approach | Comments |
|---------------------------------|---|
| Applicable Rating Methodologies | Corporate Credit Rating Methodology |
| Parent/Group Support | Not Applicable |
| Consolidation/Standalone | Standalone |

About the company

KIL was originally incorporated as the public limited company, Shivilaxmi Mercantile Company Limited, on March 22, 1983 and was listed on the Bombay Stock Exchange (BSE). It began manufacturing diamond-studded silver jewellery from January 2008, with exports to primarily Hong Kong. To further increase its presence in the Hong Kong market, KIL set up a 100% wholly-owned subsidiary, KIL International Limited, which began operations from July 04, 2011 by trading in diamonds and jewellery.

In FY2020, the company reported a net profit of Rs. 0.57 crore on an OI of Rs. 86.29 crore, against a net profit of Rs. 0.57 crore on an OI of Rs. 83.14 crore in the previous year.

Key financial indicators (Audited)

| | FY2019 | FY2020 |
|--|--------|--------|
| Operating Income (Rs. crore) | 83.14 | 86.29 |
| PAT (Rs. crore) | 0.57 | 0.57 |
| OPBDIT/ OI (%) | 2.31% | 2.14% |
| RoCE (%) | 2.31% | 2.43% |
| Total Outside Liabilities/Tangible Net Worth (times) | 1.19 | 1.16 |
| Total Debt/ OPBDIT (times) | 16.05 | 13.68 |
| Interest Coverage (times) | 2.02 | 1.88 |

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

| | Instrument | Current Rating (FY2021) | | | Rating History for the Past 3 Years | | | |
|---|------------|--------------------------|--------------|--------------------|-------------------------------------|--------------------------------|-------------|-------------|
| | | Type | Amount Rated | Amount Outstanding | Rating | FY2020 | FY2019 | FY2018 |
| | | | | | 08-Oct-2020 | 16-Jan-2020 | 27-Dec-2018 | 15-Nov-2017 |
| 1 | Fund-based | Long-Term/ Short-Term | 25.00 | - | [ICRA]B+ (Stable)/ [ICRA]A4 | [ICRA]B+ (Stable)/ [ICRA]A4 | [ICRA]A4 | [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 No | Instrument Name | Date of Issuance / Sanction | Coupon Rate | Maturity Date | Amount Rated (Rs. crore) | Current Rating and Outlook |
|---------|--|-----------------------------|-------------|---------------|--------------------------|-----------------------------|
| NA | Foreign Bills Purchased/Discounted/Rupee Advance against Collected Bills | NA | NA | NA | 25.00 | [ICRA]B+ (Stable)/ [ICRA]A4 |

Source: KIL

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

Analyst Contacts

K. Ravichandran

+91 44 4596 4301

ravichandran@icraindia.com

Suprio Banerjee

+91 22 6114 3443

supriob@icraindia.com

Preeti Kumaran

+91 22 6169 3356

preeti.kumaran@icraindia.com

Viraj Kadwadkar

+91 22 6114 3457

viraj.kadwadkar@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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For more information, visit www.icra.in

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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