Dharmanandan Diamonds Private Limited

January 10, 2019

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based working capital facilities	1,398.16	1,413.16	[ICRA]A (Stable)/[ICRA]A1; Reaffirmed
Unallocated limits	226.84	211.84	[ICRA]A (Stable)/[ICRA]A1; Reaffirmed
Total	**1,625.00**	**1,625.00**	

*Instrument details are provided in Annexure-1

Rationale

The ratings reaffirmation continues to reflect the extensive experience of the promoters of Dharmanandan Diamonds Private Limited (DDPL) in the cut and polished diamond (CPD) industry, supported by a professional management setup, the established relationships with customers and its status as a leading player in the Indian polished diamond industry. The ratings also continue to draw comfort from the large operating base, resulting in economies of scale and the company's financial flexibility owing to considerable unencumbered cash balance as well as unsecured loans from promoters and no external long-term debt on the books. DDPL also benefits from its status as a sightholder of De Beers Global Sightholder Sales (DBGSS), alliance with Alrosa and its association with other diamond mining majors, which provides comfort on sourcing arrangements. Furthermore, the ratings continue to factor in DDPL's well established distribution network in the key consuming markets along with its growing presence in the e-commerce and mobile-based application space providing an easy access to the global market.

The strengths, however, are partially offset by DDPL's high working capital intensive nature of operation as indicated by NWC/OI of 40% in FY2018 emanating from slow receivables and high inventory holding, although higher credit availed from suppliers from the secondary market provided comfort to the working capital profile to an extent. With an export-dominated sales profile, the revenues of DDPL continue to remain vulnerable to the economic conditions in key international markets. In FY2018, therefore, DDPL's revenues were impacted by challenging demand conditions in key export markets primarily the US. Although to an extent, the same was supported by increased sales in the Hong Kong and Indian markets. Further the company's profitability levels, which is inherent to the CPD industry owing to its low value-added nature of business, have led to moderate coverage indicators. The total debt to OPBDIT stood at ~5.9x and total outside liabilities to networth at 2.2x as on March 31, 2018. Further, the vulnerability of DDPL's profitability to forex fluctuation also remains a concern given its export dominated sales profile. The forex risk is, however, partly mitigated by a natural hedge from the import of rough diamonds and hedging tools. ICRA also takes note of the contingent liabilities on the company's books as on March 31, 2018. Any materialization of these contingent liabilities will have a material impact on the credit profile.

Outlook: Stable

The Stable outlook reflects ICRA's expectation that DDPL will be able to maintain its market share within its addressable market segment and follow a prudent financial policy. Going forward, DDPL's ability to diversify its business in new markets and maintain steady performance in its traditional markets like Hong Kong, Belgium and the US will facilitate it to further ramp up its scale of operations. The ability to effectively pass on the rise in rough diamond prices to customers and improve its profitability and return indicators along with an improvement in working capital management will have a positive impact on the key credit metrics. Conversely, the outlook may be revised to Negative if there is a downturn in DDPL's business due to demand pressure resulting from the difficult market conditions in key consuming markets, which may also lead to an elongation of the receivable cycle or slowdown in turnaround of inventory, thereby stretching the working capital cycle. Furthermore, any moderation in its operating income (OI) amid softening polished diamond prices or any increase in rough diamond prices by the miners, may lead to a lower than expected profitability level. This will impact the interest coverage indicators and result in deterioration in the financial risk profile.

Key rating drivers

Credit strengths

Expensive experience of promoters in the CPD industry; professional management setup – DDPL is a family-owned business with all the key departments like sourcing, assortment, processing and marketing being headed by members of the promoter family who have more than three decades of experience in the CPD industry. The promoters and directors are assisted in their daily functioning by a team of experienced professionals with relevant experience.

Healthy market standing with status as a leading CPD exporter in India – DDPL is the flagship company of the Dharmanandan Group, which has established itself as a leading CPD exporter from India in the DBGSS sight holder category. The company was primarily involved in the processing of CPDs, before gradually forward integrating its operations into manufacturing diamond-studded jewellery. In a small way, DDPL is also involved in power generation through wind mills based in Gujarat and Maharashtra. With Rs. 5,660.5 crore generated collectively from DDPL's CPD and jewellery divisions in FY2018, the company is a large sized player in this industry.

Association with De Beers and Alrosa facilitates steady supplies of quality rough diamonds – DDPL has been a Diamond Trading Company (DTC) sight holder since 2007. DTC, the marketing arm of De Beers, sells rough diamonds only to exclusive group of manufacturers throughout the world called 'sight holders'. This enables the company to procure rough diamonds as per fixed-term contracts with DTC, which assures a wide variety as well as stable supply of rough diamonds. Direct sourcing not only assures a stable supply but also helps DDPL to procure the rough diamonds at competitive rates that are cheaper than the secondary market during an up-cycle. However, during a down-cycle when CPD companies are saddled with high inventory, the sight holders have to offload their rough purchases from such direct sources at a discount to the purchase price. In June, 2016, DDPL entered in an alliance with Alrosa, a major diamond mining company for monthly supply of rough diamonds in pre-agreed volume and assortments. Such contracts with key suppliers allow DDPL to buy rough diamonds in specific product bands over pre-decided intervals. Variance in value of each sight as well as product bands are maintained at very low levels, thereby ensuring consistent supplies. Such term contract with mining majors provides significant comfort to the company's sourcing arrangements.

Well-established distribution network and presence in e-commerce and mobile-based application space provide access to global market – In the international market, DDPL has a strong distribution network through its associate/step-down subsidiary companies in key consuming markets like Hong Kong, the US and Belgium. Furthermore, the company launched an online portal in 2009, which marked its entry into the e-commerce retail space. It has also developed a mobile-based instant messaging help-guide on WhatsApp, integrated with the Dharmanandan iOS or Android application, to assist clients with diamond inventory. DDPL's customers could place their orders as per their requirement from the ready inventory of stock available online after inspecting the product based on DDPL's grading scale (self-certified) and price bands without having to travel to the company's office. It has generated over ~20% of its total sales through its web portal in FY2018 and has an online registered user base of more than 2500 customers.

Credit challenges

Revenues vulnerable to movement in diamond prices and demand slowdown in key markets; modest profitability indicators as prevalent in the CPD business – In FY2018, the company has reported a sluggish YoY growth rate of ~4% in operating income to Rs. 5660.5 crore from Rs. 5422.7 crore in FY2017. This is attributable to challenging demand conditions in key export markets such as the US and West Asia, although the same was supported to an extent by increased sales in the Hong Kong and Indian market. Further, the company's operating margins continued to remain modest at 4.4% in FY2018 owing to the inherently low value-added in the nature of the CPD industry and its intense competitive pressures. Historically, the coverage metrics have remained moderate as represented by total debt to OPBDIT (TD/OPBDIT) of ~5.9x and total outside liabilities to networth (TOL/TNW) of 2.2x as on March 31, 2018. Nevertheless, some comfort can be drawn as ~7% of total debt is constituted by interest free promoters unsecured loan and steady improvement in the interest cover and debt service cover (OPBDIT/Interest of 3.2x and DSCR of 3.2x as on March 31, 2018).

Revenues and profitability susceptible to foreign-currency movements though natural hedge provides comfort – DDPL's revenues are primarily driven by export sales, exposing its operations to the vagaries of the currency market. Further, the company had a net foreign-exchange payable position in FY2018. However, the forex risk is partly offset by entering into forward contracts on both import and export bills.

High working-capital intensity of business operations – In FY2018, DDPL's working-capital intensity continues to remain high as indicated by NWC/OI of 40% emanating from high inventory holding and slow receivables. This has entailed increased creditor funding and high utilisation of working capital facilities in the last 12 months.

Industry characterised by severe competition from unorganised and organised players – The diamond industry is fragmented, with low value addition and intense competition. DDPL not only faces competition from unorganised players, but from a few well-established organised players as well, who are fairly large in scale. However, by being present in the diamond industry for more than three decades and by offering a variety of products over the years, DDPL has developed healthy business relationships with its customers as well as its suppliers.

Liquidity Position:

The company has reported positive fund flow from operations over the period under study. Apart from the large operating base, the company's financial flexibility is supported by sizable unencumbered cash balance, no external long-term debt on its books as well as sizable unsecured loans from promoters as of September 2018. However, the company's working capital utilisation levels stood high with average working capital utilisation exceeding 80% in the period under study.

Analytical approach:

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

About the company:

DDPL is a leading Indian diamond-manufacturing company headquartered in Mumbai with a manufacturing facility in Surat, Gujarat. As on March, 2018, it had employed over 7500 skilled and unskilled workers. DDPL is mainly involved in cutting and polishing quality diamonds, which it eventually sells to retailers and jewellers across the globe. The company manufactures diamonds in various shapes and sizes, ranging from 0.01 carat to 10 carat and distributes its products through its associate companies in Hong Kong, the US and Belgium. Moreover, it enables consumers to buy diamonds and jewellery online through its website. DDPL has held the status of sight holder and has been on DBGSS's list for the past ten years. In FY2018, the company reported a net profit of Rs. 148.6 crore on an OI of Rs. 5660.5 crore, over a net profit of Rs. 126.8 crore on an OI of Rs. 5422.7 crore in the previous year.

Key financial indicators (audited)

	FY2017	FY2018
Operating Income (Rs. crore)	5,422.7	5,660.5
PAT (Rs. crore)	126.8	148.6
OPBDIT/OI (%)	4.0%	4.4%
RoCE (%)	10%	10%
Total Debt/TNW (times)	1.4	1.2
Total Debt/OPBDIT (times)	6.7	5.9
Interest coverage (times)	2.7	3.2

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2019)				Chronology of Rating History for the Past 3 Years		
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating January 2019	Date & Rating in FY2018 January 2018	Date & Rating in FY2017 December 2016	Date & Rating in FY2016 October 2015
1	Fund-based working capital facilities	Long and Short Term	1,413.16		[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1
2	Unallocated limits	Long and Short Term	211.84		[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1	[ICRA]A (Negative)/ [ICRA]A1	[ICRA]A (Stable)/ [ICRA]A1

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	Fund-based pre and post-shipment working capital facilities	-	-	-	1,413.16	[ICRA]A (Stable)/ [ICRA]A1
NA	Unallocated limits	-	-	-	211.84	[ICRA]A (Stable)/ [ICRA]A1

Source: DDPL

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

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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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