



SMERA RATINGS LIMITED

Sovereign Diamonds Limited (SDL)

Rating Rationale

March 20, 2015

Facilities	Amount (Rs. Crore)	Rating
Cash Credit	15.00	SMERA BB/Stable (Assigned)
Export Packing Credit	2.00	SMERA BB/Stable (Assigned)
Term Loan	0.15	SMERA BB/Stable (Assigned)
Cash Credit (proposed)	3.35	SMERA BB/Stable (Assigned)
Export Packing Credit (proposed)	0.50	SMERA BB/Stable (Assigned)

SMERA has assigned a long-term rating of '**SMERA BB**' (read as **SMERA double B**) to the Rs.21.00 crore bank facilities of Sovereign Diamonds Limited (SDL). The outlook is '**Stable**'. The rating draws comfort from the company's experienced management, strong revenue growth and moderate financial risk profile. However, the rating is constrained by the company's exposure to customer concentration risk. The rating is also constrained by the company's modest scale of operations and working capital-intensive business. The rating notes that the company's profit margins are susceptible to fluctuations in gold prices. Moreover, the company faces intense competition in the diamond jewellery business.

SDL was incorporated in 1974. The company is listed on the Bombay Stock Exchange. SDL undertakes manufacturing of diamond-studded gold jewellery. The company benefits from its experienced management. Mr. Ajay Gehani, managing director of SDL, has around 25 years of experience in the gems and jewellery industry. SDL's revenues have increased at a strong compound annual growth rate (CAGR) of 33 per cent during FY2009–10 (refers to financial year, April 01 to March 31) to FY2013–14. The company's operating income has increased from Rs.34.16 crore in FY2012–13 to Rs.40.06 crore in FY2013–14.

SDL's moderate financial risk profile is marked by leverage (debt-to-equity ratio) of 1.55 times as on March 31, 2014 and interest coverage ratio of 2.11 times in FY2013–14. The company's net worth is low at Rs.9.24 crore as on March 31, 2014. SDL has registered return on capital employed (RoCE) of 13–14 per cent and operating profit margin of 8–9 per cent over the past three years.

SDL is exposed to customer concentration risk as the company derives ~75 per cent of its revenue from two clients viz. Tribhovandas Bhimji Zaveri (Mumbai) and Malabar Gold & Diamonds (UAE). SDL has modest-scale operations with operating income of Rs.40.06 crore in FY2013–14. The company is likely to register revenue of Rs.60.00 crore in FY2014–15 on the back of strong demand from existing customers. SDL's ability to register sustained growth in revenues is a key rating sensitivity.

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SDL's operations are working capital-intensive. The company's working capital cycle is stretched at 198 days in FY2013-14 mainly on account of inventory holding of 113 days and collection period of 114 days. SDL's utilization of bank limit was thus high at ~98 per cent (average) during September 2014 to February 2015. The company's working capital limits have been enhanced to Rs.17.00 crore (from Rs.15.50 crore) in March 2015. Moreover, SDL has applied for additional working capital limit of Rs.3.85 crore, which will relieve the liquidity pressure to some extent.

SDL operates in an intensely competitive segment of the diamond jewellery business, which is inherently cyclical in nature. The company's profit margins are susceptible to volatility in gold prices.

Rating sensitivity factors

- Ability to scale up operations while maintaining stable profitability
- Working capital management
- Bank limit utilization

Outlook: Stable

SMERA believes SDL will maintain a stable business risk profile over the medium term. The company will continue to benefit from its experienced management and established relations with customers. The outlook may be revised to 'Positive' in case the company registers sustained improvement in revenues, profit margins, capital structure and working capital management. Conversely, the outlook may be revised to 'Negative' in case of decline in the company's revenues or profit margins, or in case of deterioration in the company's financial risk profile and liquidity position.

About the company

SDL, incorporated in 1974, is a Mumbai-based company promoted by Mr. Ajay Gehani and Mr. Ramesh Gehani. SDL is listed on the Bombay Stock Exchange. The company undertakes manufacturing of diamond-studded gold jewellery. SDL has a processing unit in Andheri, Mumbai.

For FY2013-14, SDL reported profit after tax of Rs.1.02 crore on operating income of Rs.40.06 crore, as compared with profit after tax of Rs.0.74 crore on operating income of Rs.34.16 crore in the previous year. Further, the company reported profit after tax of Rs.1.18 crore on operating income of Rs.39.46 crore during April 2014 to December 2014, as compared with profit after tax of Rs.0.62 crore on operating income of Rs.25.27 crore in the corresponding period of the previous year. SDL's net worth stood at Rs.9.24 crore as on March 31, 2014, as compared with Rs.8.22 crore a year earlier.

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