

Press Release

Sheetal Manufacturing Company Private Limited

October 05, 2020



Rating Reaffirmed, Assigned & Withdrawn

Total Bank Facilities Rated*	Rs. 714.00 Cr. (Reduced from Rs.914.30 Cr)
Long Term Rating	ACUITE A+/ Outlook: Negative (Reaffirmed; Outlook revised from Stable)
Short Term Rating	ACUITE A1 (Assigned)

* Refer Annexure for details

Rating Rationale

Acuité has reaffirmed the long-term rating of '**ACUITE A+**' (**read as ACUITE A plus**) and assigned the short-term rating of '**ACUITE A1**' (**read as ACUITE A one**) on the Rs. 714.00 crore bank facilities of Sheetal Manufacturing Company Private Limited (SMCPL). The outlook has been revised to '**Negative**'.

The rating reaffirmation with negative outlook reflects the cascading impact of COVID-19 induced disruptions on the gems and jewellery sector which included a reactionary trade shutdown in the key markets, restricted movements and restricted labour supply in the production units. This has also had an adverse impact on the consumer demand for discretionary items and thus resulted in the loss of export volumes. The players operating in the cut and polished diamond (CPD) segment have witnessed turbulence since FY20 with political tension in the key market of Hong Kong/China further made worse by the outbreak of COVID-19. This has led to lower financial flexibility for the industry players with significant reduction in limits effected by the lenders. While some momentum is expected from H2FY2021 onwards, on the back of festive seasons with gradual restoration of trade activity in key diamond markets across the globe, continuing severity of the pandemic will make significant recovery in demand of discretionary items like diamonds uncertain. The negative outlook also highlights the expected moderation in the credit profile of SMCPL due to slower movement of inventory, a decline in revenue and margins and consequently the moderation in its debt-protection metrics.

The ratings, however, continue to draw comfort from the extensive experience of the promoters in the CPD industry reflected by the company's established relationship with its customers and its certified status as one of the four-star export houses. Further, the company has been able to recover older receivables during the last six months ending August – 2020, which has facilitated lower bank fund utilization. SMCPL also benefits from its status as a sight holder of De Beers and its association with other diamond mining majors like Rio Tinto and Alrosa, which ensures consistent supplies at competitive rates.

About the Company

Sheetal Manufacturing Company Private Limited (SMCPL), established as a partnership in 1985 by the first-generation entrepreneurs, Mr. Govindbhai Kakadia and his two brothers- Mr. Vallabh Kakadia & Mr. Ravji Kakadia, is engaged in the manufacturing and export of cut and polished diamonds (CPD). It was then incorporated as a private limited company in 2008. The company's manufacturing facilities are located in Surat and it caters to the domestic market and key export markets like Hong Kong, USA and UAE.

Analytical Approach

Acuité has considered the consolidated business and financial risk profile of Sheetal Manufacturing Company Private Limited and its subsidiaries and step-down subsidiaries, on account of significant business and financial alignment between the entities. Details of companies considered under consolidated analysis have been entailed in Annexure.

Key Rating Drivers

Strengths

- **Extensive experience of promoters and long track record of operations**

Sheetal Group, engaged mainly into manufacture and export of cut and polished diamonds, has a global presence and is among one of the leading diamond players in India. They have a diversified customer base, based in USA, Europe, Hong Kong, Middle East, among other countries. It is also designated as four-star export house by the Government of India. This has been abled by the extensive experience of promoter of the group, Mr. Govindbhai Kakadia, who has an experience of more than five decades into this business segment. The promoter is well supported by the second generation in the family – Mr. Ajay Kakadia, Mr. Bharat Kakadia and Mr. Chirag Kakadia.

Acuité believes that the extensive experience of the management and established global presence will strengthen the business risk profile over the medium term.

- **Long standing relationship with reputed diamond mining companies in the world**

Sheetal Group has a long-term association with major diamond companies like De Beers, Rio Tinto and Alrosa for sourcing of rough diamonds. Such contracts with key suppliers like them allow a steady supply at competitive rates. Diamond Trading Company (DTC), the marketing arm of De Beers, sells rough diamonds only to an exclusive group of manufacturers throughout the world called sight holders. The status of being a sight holder with these mining companies lend significant comfort to the sourcing arrangements of Sheetal Group whereby they procure rough diamonds as per fixed-term contracts with DTC that also assures uninterrupted supply at competitive pricing rather than sourcing from secondary markets. Acuité believes that Sheetal Group will benefit from its position as a sight holder giving the company a higher competitive advantage in terms of quality over the other players present in the diamond industry.

- **Established distribution network and presence in major global markets**

In the international market, Sheetal Group has a strong distribution and procurement network through its step-down subsidiaries in key consuming markets like Hong Kong, USA, Belgium, Middle East. Further, the company has launched an online application in Feb 2015, which marked its entry into the e-commerce trading space. This mobile-based application helps in assisting customers and clients to place their orders as per their requirement from the ready inventory of stock available online after inspecting the product based on different grading scale and certificates in industry and price bands without having to travel to the company's office.

- **Healthy financial risk profile**

The group's financial risk profile is strong, marked by healthy net worth, low gearing and healthy debt protection metrics. The tangible net worth stood healthy at Rs.1,027.30 Cr as on March 31, 2020 (Est) as against Rs.846.96 Cr in the previous year. The company's leverage policy is supported by the healthy networth levels, reflected through its peak gearing and Total Outside Liabilities to Tangible Net worth (TOL/TNW) level of 1.06 times and 1.25 times as on March 31, 2018. The leverage level continues to remain supported with healthy networth with a gearing of 0.50 times and TOL/TNW of 0.59 times as on March 31, 2020 (Est). The total debt of the group stood at Rs.455.20 Cr as on March 31, 2020 (Est), comprising of short-term borrowings entirely. Further, the overall borrowings are expected to come down in the current FY2021 on account of lenders' conservative approach towards the gems and jewelry industry with respect to the current disruptions. There was no significant debt-funded capital expenditure during this period except for routine capex entailing an expense of Rs.1.5 Cr to Rs. 2 Cr funded completely out of internal accruals. The gearing is expected to be healthy in the range of 0.30 to 0.50 times over the medium term. Sheetal Group has moderate profitability margins, as characterized in the CPD segment, in the range of 3-4 percent over the last three year ended FY2020 (Est). The moderate profitably levels vis-à-vis its debt level has resulted in moderate debt protection metrics. The interest coverage ratio stood (ICR) and debt service coverage ratio (DSCR) stood at 3.25 and 2.28 times respectively for FY2020 (Est). Acuité expects the financial risk profile to remain healthy over the medium term on account of a large scale of operations, sound debt protection measures and decreasing reliance on the external borrowings resulting in stable debt protection measures.

Weaknesses

- **Relatively elongated working capital operations**

Sheetal Group's working capital operations continue to remain high with respect to the commonality observed in CPD industry. The working capital operations remained relatively elongated as observed from GCA days of 223 days in FY2020 (Est) against 181 days in FY2019. This was caused due to slower movement of inventory in FY2020 (Est) coupled with a stretch in the receivables position. Commonly, the process of procuring rough diamonds to cutting and polishing it and finally handing over to customer involves a time

frame of close to 8 to 10 months and the inventory of rough diamonds is stored for a period of 3 to 4 months. However, during Q4 of FY2020, the diamond market faced severe turbulence due to outbreak of COVID – 19 and subsequent lockdowns which led to a pile of inventory and pending receivables from customers. This has, however, been managed with key markets opening up and restoration of trade activities from Q2 FY2021 onwards enabling replenishment in the stock levels and meaningful management of the receivables. Acuité believes the working capital operations are expected to remain relatively stretched in the near to medium term on account of demand fallout of discretionary items, diamonds being a major item of discretionary goods, which will cause slow movement of inventory and delayed realization from customers due to partial lockdown across some geographies.

• Moderation in sales and profitability metrics expected to continue

Sheetal Group reported a 25 per cent decline in the revenues on a consolidated level in FY2020 (Est) when compared to last year, whereas on a standalone level the company reported 23 percent decline in the revenues. Sheetal Group mostly caters to the export markets with 55 percent of its export to China/Hong Kong. The decline is driven by the challenging environment in key export markets due to the outbreak of covid – 19 and lockdown across all geographies further accentuated by the fall in demand of discretionary items and consumer spending. This decline is expected to continue in the medium term owing to a considerable decline in its scale of operations and the price volatility of diamonds in the market. Acuité believes that any further change in operating performance of the company will remain a key rating sensitivity factor.

Rating Sensitivities

- Deterioration in the operating performance
- Any stretch in working capital operations leading to liquidity constraints

Material Covenants

1. TD/TNW < 1.5x
2. Current Ratio > 1.33x
3. Tangible Networth > INR 7,787 Mn

Liquidity: Adequate

The liquidity position of Sheetal Group remains adequate, supported by cash and bank balances of Rs.52.10 Cr and liquid investments of Rs.48.20 Cr as on March, 2020 (Est). The group also had cushion available in the form of unutilized working capital borrowings of 54 per cent as on July, 2020. While operating profitability is expected to be impacted in FY2021, cash flow from operations is expected to be supported by the release of the working capital on the back of a decline in its scale and prudent management of working capital. As in most players in CPD segment, Sheetal Group's debt profile is short term in nature for meeting the working capital requirements and does not have any scheduled debt repayment obligations. Also, there is no major debt-funded capital expenditure requirements envisaged over the near to medium term. Acuité believes the liquidity profile is expected to remain adequate over the medium term owing to sufficient liquid funds available coupled with the unutilized available bank borrowings.

Outlook: Negative

The revision in the rating outlook to negative indicates the severe effect of the pandemic on the CPD industry not only in terms of its short to medium term impact on demand but also due to trade lockdown in key markets and supply disruptions. This is likely to impact the financial risk profile of SMCPL with a possible decline in operating income and margins over the next 1-2 years. The rating may be downgraded in case of a deterioration in SMCPL's liquidity profile or higher than expected decline in operating margins and revenues, leading to substantially lower debt indicators. Conversely, the outlook may be revised to 'Stable' if the company is able to show significant improvement in operating performance duly supported by a sustainable improvement in the receivables position, working capital cycle and operating margins.

About the Rated Entity - Key Financials

	Unit	FY20 (Estimates)	FY19 (Actual)
Operating Income	Rs. Cr.	2,270.06	3,023.46
PAT	Rs. Cr.	40.20	57.19
PAT Margin	(%)	1.77	1.89
Total Debt/Tangible Net Worth	Times	0.50	0.89
PBDIT/Interest	Times	3.25	2.87

Status of non-cooperation with previous CRA (if applicable)

None

Annexure – List of entities considered for consolidated approach

Company Name	Extent of Consolidation	Ownership
Sheetal Golden Works India LLP	Full	100%
Sheetal Middle East DMCC	Full	100%
Sheetal Europe BVBA	Full	99.6%
Sheetal Fareast Limited	Full	100%
Sheetal Group USA Inc	Full	100%

Any other information

None

Applicable Criteria

- Financial Ratios and Adjustments - <https://www.acuite.in/view-rating-criteria-53.htm>
- Trading Entities – <https://www.acuite.in/view-rating-criteria-61.htm>
- Manufacturing Entities - <https://www.acuite.in/view-rating-criteria-59.htm>
- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Consolidation of Companies – <https://www.acuite.in/view-rating-criteria-60.htm>

Note on complexity levels of the rated instrument

<https://www.acuite.in/view-rating-criteria-55.htm>

Rating History (Upto last three years)

Date	Name of Instrument/Facilities	Term	Amount (Rs. Cr)	Ratings/Outlook
01-Aug-2019	EPC/PCFC	Long Term	166.00	ACUITE A+/Stable (Assigned)
	Cash Credit	Long Term	45.00	ACUITE A+/Stable (Assigned)
	PSC	Long Term	169.00	ACUITE A+/Stable (Assigned)
	Proposed Facility	Long Term	11.00	ACUITE A+/Stable (Assigned)
	PSC	Long Term	35.00*	ACUITE A+/Stable (Assigned)
	Bills Discounting/PCFC	Long Term	58.30	ACUITE A+/Stable (Assigned)
	Bills Discounting	Long Term	69.00^	ACUITE A+/Stable (Assigned)
	EPC/PCFC	Long Term	54.00	ACUITE A+/Stable (Assigned)
	PSC/PCFC	Long Term	28.00	ACUITE A+/Stable (Assigned)
	PCFC	Long Term	25.00	ACUITE A+/Stable (Assigned)
	PSC	Long Term	26.00	ACUITE A+/Stable (Assigned)
	PSC	Long Term	25.00#	ACUITE A+/Stable (Assigned)
	Bills Discounting	Long Term	25.00	ACUITE A+/Stable (Assigned)
	PCFC	Long Term	4.00	ACUITE A+/Stable (Assigned)
	Letter of Credit	Long Term	104.00	ACUITE A+/Stable (Assigned)

	Letter of Credit	Long Term	70.00	ACUITE A+/Stable (Assigned)
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*sublimit of EPC/PCFC of Rs. 17.50 Cr

^sublimit of PC/PCFC of Rs. 31.20 Cr

#sublimit of PC/PCFC of Rs.20.00 Cr

*Annexure – Details of instruments rated

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
EPC/PCFC	Not Applicable	Not Applicable	Not Applicable	132.00**	ACUITE A+/Negative (Reaffirmed)
Cash Credit	Not Applicable	Not Applicable	Not Applicable	45.00	ACUITE A+ (Withdrawn)
PSC	Not Applicable	Not Applicable	Not Applicable	133.00***	ACUITE A+/Negative (Reaffirmed)
Proposed Facility	Not Applicable	Not Applicable	Not Applicable	11.00	ACUITE A+ (Withdrawn)
PSC	Not Applicable	Not Applicable	Not Applicable	24.00*	ACUITE A+/Negative (Reaffirmed)
Bills Discounting/PCFC	Not Applicable	Not Applicable	Not Applicable	25.00&	ACUITE A+/Negative (Reaffirmed)
Bills Discounting	Not Applicable	Not Applicable	Not Applicable	69.00^	ACUITE A+/Negative (Reaffirmed)
EPC/PCFC	Not Applicable	Not Applicable	Not Applicable	44.12^^	ACUITE A+/Negative (Reaffirmed)
PSC/PSCFC	Not Applicable	Not Applicable	Not Applicable	22.88^^^	ACUITE A+/Negative (Reaffirmed)
PCFC	Not Applicable	Not Applicable	Not Applicable	20.00+	ACUITE A+/Negative (Reaffirmed)
PSC	Not Applicable	Not Applicable	Not Applicable	19.00++	ACUITE A+/Negative (Reaffirmed)
PSC	Not Applicable	Not Applicable	Not Applicable	25.00#	ACUITE A1 (Assigned)
Bills Discounting	Not Applicable	Not Applicable	Not Applicable	15.00~	ACUITE A1 (Assigned)
PSC	Not Applicable	Not Applicable	Not Applicable	4.00	ACUITE A+ (Withdrawn)
Letter of Credit	Not Applicable	Not Applicable	Not Applicable	104.00	ACUITE A+/Negative (Reaffirmed)
Letter of Credit	Not Applicable	Not Applicable	Not Applicable	70.00	ACUITE A+/Negative (Reaffirmed)
Proposed	Not Applicable	Not Applicable	Not Applicable	11.00	ACUITE A1 (Assigned)

*sublimit of EPC/PCFC of Rs.12 Cr; Reduced from Rs. 35 Cr

** CC sublimit of Rs. 20 Cr; Reduced from Rs.166 Cr

&Reduced from Rs. 58.30 Cr

***Reduced from Rs.169 Cr

^ sublimit of PC/PCFC of Rs. 31.20 Cr

^^, ^^^ Reduced from Rs. 54 Cr & Rs. 28 Cr respectively

+, ++ Reduced from Rs. 25 Cr & Rs. 26 Cr respectively

sublimit of PC/PCFC of Rs. 20 Cr

~ Reduced from Rs. 25 Cr

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About Acuité Ratings & Research:

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