

Press Release

Karp Impex Limited

August 31, 2020

Rating Downgraded



Total Bank Facilities Rated*	Rs. 1,050.00 Cr.
Long Term Rating	ACUITE BBB-/ Outlook: Negative (Downgraded)

* Refer Annexure for details

Rating Rationale

Acuité has downgraded the long-term rating to '**ACUITE BBB-**' (read as **ACUITE triple B minus**) from '**ACUITE BBB**' (read as **ACUITE triple B**) on the Rs. 1,050.00 crore bank facilities of Karp Impex Limited (KIL). The outlook is '**Negative**'.

Reason for Downgrade

The rating downgrade is based on the declining operating performance continuing from the past three years as exhibited by revenues of Rs.1,699 Cr in FY2020 (Prov.) as against Rs.2,594 Cr in FY2018. The operating performance has been impacted on account of political disruptions coupled with the impact of COVID – 19 in the last quarter of FY2020. The outbreak of coronavirus has led to lockdowns across the globe, thus restricting the movements of good and people. This is likely to impact the economic conditions of various countries across the globe. In the event of prolonged economic slowdown due to myriad factors like natural calamities, there could be job losses and consequently slowdown in retail spending by the consumers. While the challenges will be more acute in the discretionary segments, players like KIL is likely to be impacted.

KIL, operating under this industry is expected to remain impacted with respect to pile up of inventory and elongation in receivables days. This will result in higher working capital requirements. In the absence of adequate working capital requirements from the lenders, the promoters will have to pump in equity to fund its working capital requirements. Further, with higher working capital requirements and decline in sales, Acuité expects the coverage indicators of the company like interest coverage will be significantly impacted. Any higher than expected deterioration in working capital or financial risk profile of the company will impinge negative bias towards the rating.

Karp Impex Limited (KIL) was established as a partnership firm in 1983 and converted to a closely-held public limited company in 1995. KIL is engaged in processing of cut and polished diamonds. The company is also engaged in trading of polished diamonds. KIL is a DTC sight holder since 1993. The company is one of the few manufacturers for 'Forever' mark diamonds. KIL is an exclusive supplier of patented cut and polished diamonds set in writing instruments and women's accessories manufactured by Mont Blanc. KIL derives ~86 per cent of its revenues from manufacturing and processing of cut and polished diamonds, while the remaining revenues arise from trading of cut and polished diamonds and rough diamonds.

Analytical Approach

Acuité has taken the standalone approach while assessing the business and financial risk profile of KIL to arrive at the rating.

Key Rating Drivers

Strengths

- **Experienced management and established track record of operations**

KIL started operations in 1983 to process and sell polished diamonds. The promoters, Mr. Anil B. Virani and Mr. Kishore B. Virani have more than 3 decades of experience in the diamond industry. This has helped the company in maintaining good business relations with clients. KIL and its other group companies have offices in key diamond centers of the world such as Hong Kong, Belgium and Dubai. Acuité believes the experience of the promoters will help the company in maintaining their business risk profile on the back of established track of operations in the near to medium future.

- **Healthy financial risk profile**

KIL's financial risk profile is healthy, marked by healthy net worth, comfortable gearing, however constrained by moderate debt protection metrics. The tangible net worth stood healthy at Rs.707.15 Cr as on March 31, 2020 (Prov). The growth in net worth is fueled by healthy accretion to reserves. The Gearing and Total outside Liabilities to Tangible net worth (TOL/TNW) stood at 0.90 times and 1.27 times as on March 31, 2020 (Prov) compared to little or no change from the previous year. The total debt stood at Rs.639.28 Cr as on March 31, 2020 (Prov), which comprises entirely of short-term debt.

KIL has modest profitability margin in the range of 3-5 percent over the last three year ended FY2020 (Prov). The modest profitability levels vis-à-vis the high debt level has resulted in moderate debt protection metrics. The interest coverage ratio stood (ICR) and debt service coverage ratio (DSCR) stood at 1.62 times, both, respectively for FY2020 (Prov). The company reported net cash accruals of Rs.28.91 Cr in FY2020 (Prov) vis-à-vis nil repayment obligations. The net cash accruals to total debt (NCA/TD) stood at 0.05 times in FY2020 (Prov). Acuite expects the financial risk profile to remain healthy over the medium term on account of healthy network profile supported by healthy accretions to reserves.

Weaknesses

- **Working capital intensive operations**

The company's operations are working capital intensive, marked by Gross Current Assets days of 323 days in FY2020 (Prov) as against 235 in FY2019. The deterioration in FY2020 over FY2019 is mainly on account of increase in receivable period (mention this first, cause, this is the major reason of deterioration) inventory holding period to 123 days in FY2020 (Prov) as against 115 days in FY2019. The receivable period has also increased to 202 days in FY2020 (Prov) as against 121 days in FY2019. The lengthy working capital cycle is attributed to its dealings in large and fancy diamonds which tend to have lesser turnaround in inventory. Besides the impact of political unrest in Hong Kong market since last 1.5 years and the recent incident of the outbreak of coronavirus followed with lockdowns have severely impacted the recovery from customers. Acuite believes the company is likely to face further liquidity pressure due to elongated working capital cycle in the near term to medium future.

- **Geographic concentration sales**

KIL's revenue constitutes ~80 percent exports. Out of this, exports revenue from Hong Kong stood at 54 percent in FY2020 (Prov). This is indicative of high geographic concentration. Also, recent developments in the Hong Kong market with the outbreak of coronavirus disease and the lockdown in the Hong Kong market, KIL's revenue remain impacted.

- **Deterioration in operating performance**

KIL's topline has declined in the last three years from Rs.2,594 Cr in FY2018 to Rs.1,699 Cr in FY2020 (Prov). The margins have also remained fluctuating exhibited by 4.5 percent in FY2020 (Prov) compared to 5.15 percent in FY2019 and 3.60 percent in FY2018. This fluctuation is deliberated by the changing dynamics in the Hong Kong market, it is the major trading centre for KIL, coupled with reduced bank limits. Further, revenues are expected to remain subdued in FY2021 due to the outbreak of COVID – 19 with a major shift in demand leading to reduced consumer spending in discretionary items. Acuite believes that any further change in operating performance of the company will remain a key rating sensitivity factor.

- **Vulnerable trade dynamics in Hong Kong**

Hong Kong has been undergoing political unrest since long now and the situation there has further aggravated due to the outbreak of coronavirus disease coupled with the lockdown. Trade dynamics have remained conducive in such an environment. Hong Kong is also the major market for gems and jewellery items, especially diamonds and hence players operating from such market are expected to remain impacted due to this vulnerability. This further will affect the recovery from customers.

Rating Sensitivities

- Deterioration of operations performance
- Any further stretch in receivables leading to liquidity constraints

Material Covenants

None

Liquidity: Stretched

The liquidity of the company is stretched, marked by high GCA days of 323 days in FY2020 (Prov) as

against 235 days in FY2019. This is driven majorly by high inventory holding and stretch in receivable days. Further, the liquidity remains affected due to bank's sceptic outlook on the diamond industry, with respect to the recent incidents, by capping the limits available. KIL has also taken moratorium under the recent RBI guidelines for COVID – 19 and the bills fall due by the end of August-2020. The company has unencumbered cash and bank balance of Rs.3.21 Cr as on March 31, 2020 (Prov). Acuite believes the liquidity of KIL is expected to remain stretched on account of piling up of receivables and inventory holding aggravated by reducing bank lines available.

Outlook: Negative

Acuite believes that the outlook on KIL continues to remain 'Negative' on account of continuous deterioration in the business risk profile of the company. Further, the business and financial risk profile of the company is expected to be impacted on account of significant impact on discretionary spending pattern and challenges faced on supply and demand side due to outbreak of COVID – 19 followed by lockdowns across the globe. The rating may be further downgraded in case of continued moderation in liquidity profile and higher than expected decline in operating performance, leading to further deterioration in debt protection indicators. Conversely, the outlook may be revised to 'Stable' if the company is able to show significant improvement in operating performance duly supported by the unwinding of growing receivables, infusion of equity, improvement in the working capital cycle and operating margins.

About the Rated Entity - Key Financials

	Unit	FY20 (Prov)	FY19 (Actual)
Operating Income	Rs. Cr.	1,698.27	2,083.70
PAT	Rs. Cr.	16.46	17.50
PAT Margin	(%)	0.97	0.84
Total Debt/Tangible Net Worth	Times	0.91	0.90
PBDIT/Interest	Times	1.64	1.61

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

CARE, vide its press release dated July 05, 2019 had denoted the rating of KARP IMPEX LIMITED as 'CARE BB; ISSUER NOT CO-OPERATING' on account of lack of adequate information required for monitoring the ratings.

Any other information

None

Applicable Criteria

- Financial Ratios and Adjustments - <https://www.acuite.in/view-rating-criteria-53.htm>
- Manufacturing Entities - <https://www.acuite.in/view-rating-criteria-59.htm>
- Default Recognition - <https://www.acuite.in/view-rating-criteria-52.htm>
- Trading Entities - <https://www.acuite.in/view-rating-criteria-61.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
14-Mar-20219	Packing Credit	Long Term	379.38	ACUITE BBB/Negative (Downgraded)
	Post Shipment Credit	Long Term	521.12	ACUITE BBB/Negative (Downgraded)
	Proposed Packing Credit	Long Term	149.50	ACUITE BBB/Negative (Downgraded)
16-July-2018	Packing Credit	Long Term	399.90	ACUITE BBB+/Stable (Upgraded)
	Post Shipment Credit	Long Term	587.40	ACUITE BBB+/Stable (Upgraded)
	Proposed Packing Credit	Long Term	62.70	ACUITE BBB+/Stable (Upgraded)

29-Aug-2016	Packing Credit	Long Term	399.90	ACUITE BBB/Stable (Reaffirmed)
	Packing Credit	Long Term	23.35	ACUITE BBB/Stable (Withdrawn)
	Post Shipment Credit	Long Term	23.35	ACUITE BBB/Stable (Withdrawn)
	Post Shipment Credit	Long Term	587.40	ACUITE BBB/Stable (Reaffirmed)
	Proposed Packing Credit	Long Term	62.70	ACUITE BBB/Stable (Reaffirmed)

***Annexure – Details of instruments rated**

Name of the Facilities	Date of Issuance	Coupon Rate	Maturity Date	Size of the Issue (Rs. Cr.)	Ratings/Outlook
Packing Credit	Not Applicable	Not Applicable	Not Applicable	379.38	ACUITE BBB-/Negative (Downgraded)
Post Shipment Credit	Not Applicable	Not Applicable	Not Applicable	521.12	ACUITE BBB-/Negative (Downgraded)
Proposed Packing Credit	Not Applicable	Not Applicable	Not Applicable	149.50	ACUITE BBB-/Negative (Downgraded)

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About Acuité Ratings & Research:

Acuité Ratings & Research Limited is a full-service Credit Rating Agency registered with the Securities and Exchange Board of India (SEBI). The company received RBI Accreditation as an External Credit Assessment Institution (ECAI), for Bank Loan Ratings under BASEL-II norms in the year 2012. Since then, it has assigned more than 8,000 credit ratings to various securities, debt instruments and bank facilities of entities spread across the country and across a wide cross section of industries. It has its Registered and Head Office in Mumbai.

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