Red Exim

September 30, 2024

Facilities/Instruments	Amount (₹ crore)	Rating[1]	Rating Action
Long-term bank facilities	95.00	CARE BBB-; Stable	Downgraded from CARE BBB; Negative
Long-term / short-term bank facilities	15.00	CARE BBB-; Stable / CARE A3	Downgraded from CARE BBB; Negative / CARE A3+

Details of instruments/facilities in Annexure-1.

Rationale and key rating drivers

Ratings downgrade factors in the deterioration in the scale of operations and stretch in the working capital cycle of Red Exim (RE) due to industry-wide demand headwinds and declining prices and subdued demand outlook for polished diamonds amid inflationary pressure and unwinding of surplus liquidity in key consuming regions such as US and Hong Kong. RE's total operating income (TOI) declined by ~23% y-o-y to ₹574.48 crore in FY24 against ₹744.73 crore in FY23 with its profit after tax (PAT) declining by ~36% y-o-y to ₹7.43 crore in FY24 as compared to ₹11.37 crore in FY23 considering lower absorption of fixed costs, while its profit before interest, lease, depreciation and tax (PBILDT) margin sustained between 4% and 5% considering the firm's presence in small-sized diamonds where the price decline was comparatively lower. In 5MFY25, it has reported a TOI of ₹174.51 crore against 5MFY24 TOI of ₹229.82 crore. Additionally, the firm's working capital intensity remains high as reflected by elongation in operating capital cycle to 181 days in FY24 against 135 days in FY23 mainly driven by increase in inventory days. CARE Ratings Limited (CARE Ratings) expects RE's scale of operations to remain under pressure in the near-to-medium term with uncertain demand conditions in its key export destinations, which could further impact its operating cycle. CARE Ratings will continue to monitor RE's operating cycle, and further deterioration remains a key rating sensitivity.

Ratings continue to factor in RE's comfortable capital structure marked by overall gearing at 0.40x and total outside liabilities to tangible net worth (TOL/TNW) at 0.72x with a TNW of ₹234.02 crore as on March 31, 2024. Its debt coverage indicators also stood adequate marked by interest coverage at 4.40x in FY24. Ratings continue to derive comfort from the extensive domain experience of the management of CDCPL for over four decades, the company's long track record of operations in the cut and polished diamond (CPD) industry and its established relationships with customers and suppliers.

However, ratings continue to remain constrained by its working capital intensive operations. The profit margins remain constrained by the limited value additive nature of the business and stiff competition from unorganised and organised players, resulting in limited pricing power. The margins also remain exposed to fluctuations in prices of rough and polished diamonds. Being a net importer, the firm's profitability also remains vulnerable to foreign exchange fluctuations though natural hedge by exports and forward contracts mitigate the risk to an extent. Ratings also continue to consider the risks associated with RE status as a partnership concern, wherein substantial withdrawal from the capital account can adversely impact its capital structure.

Rating sensitivities: Factors likely to lead to rating actions

Positive Factors

- Consistently growing scale of operations over ₹600 crore and sustenance of PBILDT margin.
- Effective management of its working capital requirements leading to reducing reliance on working capital borrowings and improving operating cycle below 150 days on a sustained basis.

Negative Factors

- Significantly lower-than-envisaged turnover and profitability margins leading to deteriorating cash accruals.
- Deteriorating overall gearing ratio above 1.00x
- Elongation in its operating cycle to beyond 250 days on a sustained basis.

Analytical approach: Standalone

Outlook: Stable

The stable outlook reflects CARE Ratings' expectations that RE will continue to maintain an adequate financial risk profile in the medium term while benefiting from its established operational track record and experience of promoters.

Detailed description of key rating drivers:

Key strengths

Experienced partners in the CPD industry

RE was established in 2010 as a partnership firm by brothers Sujal H. Shah and Heman H. Shah. Sujal Shah started working in the diamond industry in 1987. He initially started with assortment and then moved to Antwerp, Belgium to work in the diamond

[1]Complete definition of ratings assigned are available at www.careedge.in and other CARE Ratings Limited's publications.

industry. Heman Shah also started working in the diamond industry in 1987 and gathered professional experience in manufacturing, including cutting, polishing, and assortment. Both the partners are actively involved in day-to-day operations of the firm and are duly supported by a team of experienced middle-level managers and staff.

Above average financial risk profile
The firm's financial risk profile is above average marked by moderate net worth with no long-term repayment obligation, low gearing and above average debt protection indicators. The net worth stood healthy at ₹234.02 crore as on March 31, 2024 (PY: ₹229.62 crore) considering accretion of reserves. The capital structure remained comfortable, marked by overall gearing at 0.40x (PY:0.36x) and TOL/TNW at 0.72x (PY: 0.97) as on March 31, 2024. Debt protection metrics stood at comfortable levels marked by interest coverage ratio although marginally deteriorated to 4.40x in FY24 (PY: 6.60x) considering increase in the interest cost. In Q1FY25, the interest coverage stood at 9.12x considering lower working capital utilisation.

Established sourcing network
RE has established a strong sourcing network over the years wherein it procures from both mining companies and secondary markets. However, majority of its requirement of rough diamonds is from secondary markets. RE does not have fixed long-term supply contracts with their suppliers and purchases from them based on their requirements and prices. RE procures rough diamonds through bidding-based procurement from secondary market through advance payment / COD and from very few suppliers it gets credit period of 90-120 days. RE does not have significant reliance on supplier in bidding-based procurement with procurement from top 10 suppliers accounting for ~58.52% of total rough diamonds purchase in FY24 (PY: ~55.48%).

Established clientele with presence across multiple geographies
RE has a global presence with clients based out of almost all the major gems and jewellery hubs in the world. The firm exports contributing around 34.62% in FY23 as compared to 44.41% in FY22. Revenue-wise, apart from India, Hong Kong continues to remain the major market for RE accounting for about 10.97% of total sales in FY24 followed by Belgium contribution of 7.86%. The firm draws operational efficiencies from its diverse product profile and varied client base across geographies.

Key weaknesses

Working capital intensive operations
RE's operations are working capital intensive reflected by operating cycle of 181 days in FY24 as compared to 135 days in FY23 primarily driven by higher inventories. The inventory holding period also remains high amid subdued global demand conditions. The increase in inventory days is partly attributable to lower revenue in FY24 as the total inventory Y-o-Y has declined to ₹237.94 crore as March 31, 2024 (PY: ₹299.87 crore). However, the firm's utilisation of bank limits remained moderate at 52.08% in the 12-month period ended June 2024, giving it an adequate liquidity buffer. In FY24, average inventory days remained higher at 177 days (PY: 147 days) and average collection days stood at 69 days (PY: 49 days), whereas average creditor days stood at 65 days (PY: 61 days). CARE Ratings will continue to monitor RE's operating cycle and further deterioration remains a key rating sensitivity.

Moderation in performance in FY24, likely to remain constrained by continued uncertainty
The firm's TOI has declined by ~23% Y-o-Y to ₹574.48 crore in FY24 as compared to ₹744.73 crore in FY23, however, stood at moderate levels. The decline was attributed to the overall demand slump in CPD industry and falling prices of polished diamonds. However, RE mainly deals in low carat diamonds, where decline in prices was lower. PBILDT margin has remained between 4% in the last four years and it stood at 4.19% in FY24 as compared to 4.59% in FY23. RE's reported significant decline in PAT by ~36% Y-o-Y to ₹7.43 crore in FY24 as compared to ₹11.37 crore in FY23 considering decline in revenues and marginal decline in PAT margin by 41 bps. The continued uncertainty over recovery in demand for polished diamonds is likely to keep RE's operations under pressure in the near term.

Susceptibility to volatility in profitability margins and industry characterised by intense competition
Due to high inventory holding periods, the firm runs an inherent risk of volatility in rough and polished diamond prices. In FY24, the exports contributed ~35% of the revenues, which partially hedge the exchange rate fluctuation risk, the profits continue to remain susceptible to the same, as the firm mainly depends on a natural hedge for its foreign currency exposure. In FY24, RE incurred a forex gain of ₹3.99 crore (PY: loss of ₹0.28 crore). The diamond industry is fragmented, with low value addition and intense competition. HVK faces intense competition from unorganised and few established organised players, which limits its pricing power. However, the promoters' established presence in the industry for more than four decades and diverse product offerings helped HVK develop healthy business relationships with its customers and suppliers.

Constitution as a partnership firm
The credit risk profile is tempered by the constitution as partnership firm as there is an inherent risk of withdrawal of the capital which limits its financial flexibility in turn increasing the vulnerability of the capitalisation and coverage metrics. In FY24, net withdrawal stood at around ₹7.09 crore (PY: ₹2.23 crore).

Liquidity: Adequate

The firm has adequate liquidity marked by projected cash accruals between ₹10 crore and 12 crore p.a. against no long-term repayment obligations over the medium term. As of March 2024, free cash and bank stood at ₹7.49 crore. The average utilisation of working capital limits for the past 12 months ending July 2024 was 49.88%, providing cushion. As on March 31, 2024, the firm's current ratio stood at 3.48 (PY: 1.91x) and quick ratio stood at 1.31x (PY: 0.56x). The firm has no plans to undertake debt-funded capex in the medium term.

Applicable criteria

Definition of Default
Liquidity Analysis of Non-financial sector entities
Rating Outlook and Rating Watch
Manufacturing Companies
Financial Ratios – Non financial Sector
Cut and Polished Diamonds
Short Term Instruments

About the company and industry

Industry classification

Macroeconomic indicator	Sector	Industry	Basic industry
Consumer discretionary	Consumer durables	Consumer durables	Gems, jewellery and watches

RE was established in 2010 as a partnership firm by brothers, Sujal H. Shah and Heman H. Shah. RE is into processing rough diamonds and selling CPD. RE supplies polished diamonds in different sizes, shapes, and colour, with specialisation in round and fancy shape diamonds from 0.003 to three carats white with more focus on smaller diamonds (<1 carat). RE is primarily an export-oriented firm with exports largely in markets, including Hong Kong. The firm procures its rough diamonds from both mining companies and secondary markets. RE has three units, one of them, at Dahisar, Mumbai (smaller unit) is owned by the firm, whereas manufacturing is outsourced to Supergems India Pvt. Ltd. The other two units in Surat are owned and managed by Shivam Export and Bhargavi Gems Private Limited. The entire cutting and polishing of diamonds at Surat is also done by Shivam Export on a job work basis.

Brief Financials (₹ crore)	March 31, 2023 (A)	March 31, 2024 (A)	Q1FY25 (UA)
Total operating income	744.73	574.48	107.85
PBILDT	34.19	24.08	6.18
PAT	17.82	11.37	3.51
Overall gearing (times)	0.36	0.40	NA
Interest coverage (times)	6.94	4.40	9.12

A: Audited UA: Unaudited; NA: Not available Note: these are latest available financial results

Status of non-cooperation with previous CRA: Not applicable

Any other information: Not applicable

Rating history for last three years: Annexure-2

Detailed explanation of covenants of rated instrument / facility: Annexure-3

Complexity level of instruments rated: Annexure-4

Lender details: Annexure-5

Annexure-1: Details of instruments/facilities

Name of the Instrument	ISIN	Date of Issuance (DD-MM-YYYY)	Coupon Rate (%)	Maturity Date (DD-MM-YYYY)	Size of the Issue (₹ crore)	Rating Assigned and Rating Outlook
Fund-based - LT-EPC/PSC		-	-	-	95.00	CARE BBB-; Stable
Fund-based/Non-fund-based-LT/ST		-	-	-	15.00	CARE BBB-; Stable / CARE A3

Annexure-2: Rating history for last three years

Sr. No.	Name of the Instrument/Bank Facilities	Current Ratings			Rating History			
		Type	Amount Outstanding (₹ crore)	Rating	Date(s) and Rating(s) assigned in 2024-2025	Date(s) and Rating(s) assigned in 2023-2024	Date(s) and Rating(s) assigned in 2022-2023	Date(s) and Rating(s) assigned in 2021-2022
1	Fund-based - LT-EPC/PSC	LT	95.00	CARE BBB-; Stable	-	1)CARE BBB; Negative (27-Feb-24) 2)CARE BBB; Stable (06-Oct-23)	1)CARE BBB; Stable (31-Mar-23) 2)CARE A4+; ISSUER NOT COOPERATING* (09-Dec-22)	1)CARE A4+; ISSUER NOT COOPERATING* (21-Oct-21)
2	Fund-based/Non-fund-based-LT/ST	LT/ST	15.00	CARE BBB-; Stable / CARE A3	-	1)CARE BBB; Negative / CARE A3+ (27-Feb-24) 2)CARE BBB; Stable / CARE A3+ (06-Oct-23)	1)CARE BBB; Stable / CARE A3+ (31-Mar-23) 2)CARE BB+; Stable / CARE A4+; ISSUER NOT COOPERATING* (09-Dec-22)	1)CARE BB+; Stable / CARE A4+; ISSUER NOT COOPERATING* (21-Oct-21)

LT: Long term; ST: Short term; LT/ST: Long term/Short term

Annexure-3: Detailed explanation of covenants of rated instruments/facilities: Not applicable

Annexure-4: Complexity level of instruments rated

Sr. No.	Name of the Instrument	Complexity Level
1	Fund-based - LT-EPC/PSC	Simple
2	Fund-based/Non-fund-based-LT/ST	Simple

Annexure-5: Lender details

To view lender-wise details of bank facilities please click here

Note on complexity levels of rated instruments: CARE Ratings has classified instruments rated by it based on complexity. Investors/market intermediaries/regulators or others are welcome to write to care@careedge.in for clarifications.

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About us:
Established in 1993, CARE Ratings is one of the leading credit rating agencies in India. Registered under the Securities and Exchange Board of India, it has been acknowledged as an External Credit Assessment Institution by the RBI. With an equitable position in the Indian capital market, CARE Ratings provides a wide array of credit rating services that help corporates raise capital and enable investors to make informed decisions. With an established track record of rating companies over almost three decades, CARE Ratings follows a robust and transparent rating process that leverages its domain and analytical expertise, backed by the methodologies congruent with the international best practices. CARE Ratings has played a pivotal role in developing bank debt and capital market instruments, including commercial papers, corporate bonds and debentures, and structured credit.

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