December 18, 2023

Sovereign Metals Limited: Ratings upgraded to [ICRA]BBB-(Stable)/[ICRA]A3

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based – Cash Credit	50.00	50.00	[ICRA]BBB-(Stable); upgraded from [ICRA]BB+(Stable)
Short-term – Non-Fund based – SBLC	140.00	140.00	[ICRA]A3; upgraded from [ICRA]A4+
Short-term – Fund based	150.00	150.00	[ICRA]A3; upgraded from [ICRA]A4+
Short-term – Non-Fund based – Forward Cover	10.00	10.00	[ICRA]A3; upgraded from [ICRA]A4+
Long-term / Short Term – Unallocated	100.00	100.00	[ICRA]BBB-(Stable)/ [ICRA]A3; upgraded from [ICRA]BB+(Stable)/[ICRA]A4+
Total	**450.00**	**450.00**	

**Instrument details are provided in Annexure-I*

Rationale

The ratings upgrade takes into consideration the improvement in Sovereign Metals Limited's (SML) debt coverage metrics witnessed over the recent years, which are likely to sustain in the near future. The company's debt coverage metrics improved further, as reflected by TD/OPBIDTA of 1.6 times, interest coverage of 3.5 times, TOL/TNW of 2.6 times and DSCR of 2.8 times. The improvement is attributed to marginally higher cash accruals on an increased revenue base against low debt with stable interest cost. ICRA believes that the scale as well as debt protection metrics of the company in FY2024 would remain stable. Further, the company's adequate liquidity on the back of short working capital cycle, buffer in available limits and reasonable free balances, would provide comfort to its operations. The ratings continue to be supported by the extensive experience of the promoters in the gold bullion trading business in India, giving SML access to its network of customers and mitigating customer concentration risk to some extent. ICRA also notes the high refining capacity (100 MT for gold and 250 MT for silver) available with SML, placing it among the top-five domestic gold refiners in terms of capacity. While the capacity utilisation of the refinery remains low as the company is still in the ramp-up phase, an increase in the utilisation will give SML the advantage of economies of scale, which is crucial, given the low margin in the business. The company derives significant comfort from the favourable duty differential of 0.65% available for domestic gold refiners and any change in the same will be a key rating sensitivity. The ratings further take into consideration the company's policy to avoid/minimise any gold price and forex fluctuation risks by practising back-to-back order bookings.

The ratings, however, remain constrained by the low value addition in the precious metal refining business, resulting in thin operating margins for the company and strong competition from other gold refineries in India and overseas, accredited with the London Bullion Market Association (LBMA) good delivery. However, ICRA notes that SML initiated the process of seeking LBMA certification, which will support its business growth and profitability. The ratings also consider the significant regulatory risk inherent in the refining business and the fact that any adverse change in the duty structure will result in a threat to the domestic refinery business.

The Stable outlook reflects ICRA's expectations that SML would continue to benefit from the extensive experience of its promoters in the gold trading business and access to their diverse client network, which would drive its sales. ICRA also expects the available duty differential for domestic refiners to continue, supporting SML's profitability.

Key rating drivers and their description

Credit strengths

Extensive experience and track record of promoters in bullion trading business – The Shreeji Group, one of the promoters of SML, has a track record of over 20 years in the gold bullion trading business. SML benefits from the strong system, management, customer/supplier tie-ups and infrastructure support from its promoters. It also has ISO certifications in place as well as a modern laboratory with the latest equipment.

Low working capital intensity – SML requires 2-3 days for refining gold and silver due to which the inventory is very low (5 days). Moreover, all the company's sales are order backed, which enable the company to have low debtor (6 days) and creditor days (8 days). The net working capital intensity of the company stood at 1.1% in FY2023.

Comfortable debt coverage metrics – SML's financial profile has improved consistently over the recent years on the back of low debt and improved net worth. The same led to comfortable coverage metrics, as reflected by TD/OPBIDTA of 1.6 times (2.1 times in FY2022), interest coverage of 3.5 times (3.5 times in FY2022) and DSCR of 2.8 times (2.6 times in FY2022).

Credit challenges

Inherently thin margins in gold refining business – The precious metals refining is an inherently low-margin business, given the high absolute value of the products involved and limited value addition. The transactions take place either at a premium or at a discount to the LME gold price, depending on the market conditions and supplier-customer relationships. In addition, there is a duty differential of 0.65% available for domestic refiners, which adds to the margins. The operating margins for established players in the refining business are less than 1%, which imply that SML's build-up in scale would result in increasing profits at an absolute level. Any adverse change in the duty structure, leading to pressure on the profitability, will be a key rating sensitivity.

Strong competition from fine gold importers – A gold refinery in India faces direct competition from banks/financial institutions and traders that directly import fine gold. International refiners that export fine gold to India are generally LBMA good delivery accredited, which ensures that the quality of gold meets international standards. ICRA notes that the company has initiated the process to get LBMA accreditation, which will make it eligible to source gold dore directly from the international miners. Consequently, the company would be one of the few such entities in India.

Exposure to regulatory risks associated with refinery business – The available duty differential of 0.65% with respect to imported fine gold gives the domestic refiners enough spread to run profitable operations. However, any reduction in this duty differential through changes in Government policies may erode the margins for SML and significantly impact its operations. Additionally, licence for gold dore import has been made mandatory by the Directorate General of Foreign Trade, Government of India, since June 2018. This licence requires the Bureau of Indian Standards (BIS) to audit the refinery and the refining process. Though SML already has import licence, any issues highlighted by BIS in the future can result in a delay in renewal of the same and thus, significantly impact SML's operations.

Liquidity position: Adequate

SML's liquidity position is adequate, considering cash accruals of more than Rs. 15.00 crore likely in FY2024 and future years, which would be adequate to cover its debt service obligations, primarily only interest in the absence of any term loan. Moreover, the company maintains reasonable free balances for any urgent payments, as reflected by cash and liquid investments of Rs. 36.80 crore as on March 31, 2023. Additionally, the low working capital intensity of the company's operations provides comfort to its liquidity. The company has a sanctioned fund-based working capital facility of Rs. 50.0 crore, the average utilisation of which remained at 50% over the past 12 months. The company derives comfort from unsecured loans from the promoters worth Rs. 9.43 crore as on March 31, 2023, which are interest free with flexible repayment terms.

Rating sensitivities

Positive factors – A significant ramp-up in capacity utilisation of the refinery, leading to a growth in scale and profitability along with comfortable liquidity position on a sustained basis, may lead to ratings upgrade. Specific credit metrics that could lead to ratings upgrade include an interest coverage of more than 3.0 times on a sustained basis.

Negative factors – Any adverse change in the duty structure, a decline in the expected profit margin or a stretch in the company's working capital cycle may result in ratings downgrade.

Analytical approach

Analytical Approach	Comments
Applicable rating methodologies	Corporate Credit Rating Methodology
Parent/Group support	Not applicable
Consolidation/Standalone	The ratings are based on the company's standalone financial profile.

About the company

SML is involved in refining and trading of precious metals like gold and silver. The company was incorporated in February 2012 by the Edelweiss Group, a reputed commodity and security trading house, as Edelweiss Metals Limited. The Edelweiss Group, as a part of its business policy, decided to hive off its non-core commodity business and focus on the core financial services business. Consequently, the company was taken over by the Shreeji Group along with the Lakhi and Mehta families in October 2017 and was renamed as Sovereign Metals Limited. The refinery unit is located at Naroda, Ahmedabad (Gujarat) and has a refining capacity of 100 MT of gold and 250 MT of silver. It is an ISO 9001 and ISO 14001 certified company.

Key financial indicators (audited)

	FY2022	FY2023
Operating income	5,558.5	6,288.5
PAT	7.5	11.8
OPBDIT/OI	0.5%	0.6%
PAT/OI	0.1%	0.2%
Total outside liabilities/Tangible net worth (times)	1.7	2.6
Total debt/OPBDIT (times)	2.1	1.6
Interest coverage (times)	3.5	3.5

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2024)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					Dec 18, 2023	Sep 29, 2022	Sep 30, 2021	Sep 25, 2020
1	**Fund-based – Cash credit**	Long-term	50.00	-	**[ICRA]BBB- (Stable)**	**[ICRA]BB+ (Stable)**	**[ICRA]BB (Stable)**	**[ICRA]BB (Stable)**
2	**Non-fund based – SBLC**	Short-term	140.00	-	**[ICRA]A3**	**[ICRA]A4+**	**[ICRA]A4+**	**[ICRA]A4+**
3	**Fund based**	Short-term	150.00	-	**[ICRA]A3**	**[ICRA]A4+**	-	-
4	**Non-fund based – Forward cover**	Short-term	10.00	-	**[ICRA]A3**	**[ICRA]A4+**	-	-
5	**Unallocated limits**	Long-term/ Short Term	100.00	-	**[ICRA]BBB- (Stable)/ [ICRA]A3**	**[ICRA]BB+ (Stable)/ [ICRA]A4+**	**[ICRA]BB (Stable)/ [ICRA]A4+**	**[ICRA]BB (Stable)/ [ICRA]A4+**

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term – Fund based – Cash credit	Simple
Short-term – Non-fund based – SBLC	Very simple
Short-term – Fund based	Simple
Short-term – Non-fund based – Forward cover	Simple
Long-term/ Short-term - Unallocated limits	Not applicable

The Complexity Indicator refers to the ease with which the returns associated with the rated instrument could be estimated. It does not indicate the risk related to the timely payments on the instrument, which is rather indicated by the instrument's credit rating. It also does not indicate the complexity associated with analysing an entity's financial, business, industry risks or complexity related to the structural, transactional or legal aspects. Details on the complexity levels of the instruments are available on ICRA's website: Click Here

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Long-term – Fund based – Cash credit	NA	12.0%	NA	50.00	[ICRA]BBB- (Stable)
NA	Short-term – Non-fund based – SBLC	NA	NA	NA	140.00	[ICRA]A3
NA	Short-term – Fund based	NA	NA	NA	150.00	[ICRA]A3
NA	Short-term – Non-fund based – Forward cover	NA	NA	NA	10.00	[ICRA]A3
NA	Long-term/ Short-term - Unallocated limits	NA	NA	NA	100.00	[ICRA]BBB-(Stable)/[ICRA]A3

Source: Company

Please click here to view details of lender-wise facilities rated by ICRA

Annexure II: 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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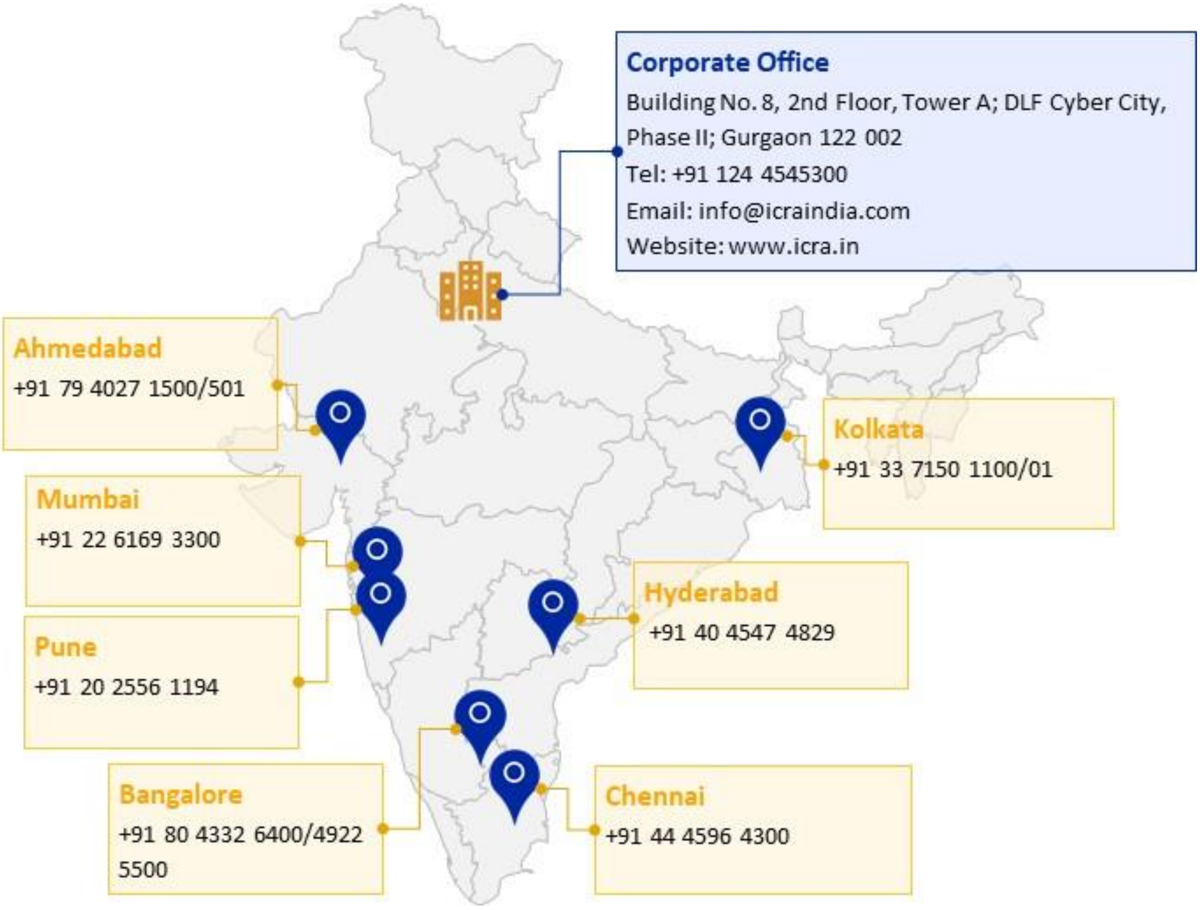

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