October 25, 2022

Ethos Limited: Rating upgraded and outlook revised to Stable for fixed deposits; rating also upgraded and outlook revised to Stable as well as withdrawn for bank facilities

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based/ Cash Credit	56.00	0.00	[ICRA]A-(Stable); upgraded from [ICRA]BBB+(Positive), outlook revised to Stable from Positive and withdrawn
Fund-based/ Term loan	3.65	0.00	[ICRA]A-(Stable); upgraded from [ICRA]BBB+(Positive), outlook revised to Stable from Positive and withdrawn
Non-fund Based	5.35	0.00	[ICRA]A2+; upgraded from [ICRA]A2 and withdrawn
Unallocated	5.00	0.00	[ICRA]A-(Stable)/[ICRA]A2+; upgraded from [ICRA]BBB+(Positive)/[ICRA]A2, outlook revised to Stable from Positive and withdrawn
Fixed Deposits	30.00	10.00	[ICRA]A-(Stable); upgraded from [ICRA]BBB+(Positive), outlook revised to Stable from Positive
Total	**100.00**	**10.00**	

**Instrument details are provided in Annexure-1*

Rationale

The rating upgrade factors in the improvement in the company's performance in the luxury watch retail segment which continued to witness significant traction in the sales as all the stores operated normally post subsiding of the pandemic. ICRA expects the credit metric to strengthen going forward, given the repayment of entire debt from the IPO proceeds amid expectations of Ethos' store network growing in FY2023 and beyond, post the recent successful IPO. The rating continues to favourably factor in Ethos' position as the largest organised luxury watch retailer in the country. Moreover, the company's credit metrics have improved with better profitability on a growing scale. Consistent increase in the exclusive arrangements with the brands and growing share of revenues from the high luxury segment will continue to support the company's bottom line. ICRA expects Ethos' credit metrics to be healthy, led by negligible leverage and benefits to accrue from its retail network expansion.

The ratings, however, are constrained by the high working-capital intensive nature of operations in the retail segment led by high inventory requirements, which may increase further in terms of value as the company is planning to scale up its retail presence. Nevertheless, ICRA notes that the retail business shall be shoring up its inventory through equity funds in the medium term, in line with the specified purpose of IPO funds, thus limiting debt levels. Additionally, the company is exposed to forex fluctuation risk, while a substantial portion of its products is imported. Moreover, the company is exposed to competition from domestic players and international markets in the retail segment. Current global economic sentiments in the European markets can lead to fluctuating demand and supply in the near to medium term, particularly in the luxury and high luxury segment.

The Stable outlook on the [ICRA]A- rating reflects ICRA's expectation that Ethos will maintain its market position and expand its presence further through more store launches. ICRA has since withdrawn the rating assigned to the bank facilities of Ethos, in accordance with ICRA's policy on withdrawal of credit ratings, at the request of the company and based on the no objection letter received from the issuing banks.

Key rating drivers and their description

Credit strengths

Improved demand across manufacturing as well as retail segment – After subdued performance in FY2021, the company witnessed revival in demand in FY2022. After facing capacity constraints in Q4 FY2021 and Q1 FY2022 with having to shut down stores during pandemic wave, growing demand enabled the company to achieve revenue growth of ~46% from Rs 400.6 crore in FY2021 to Rs 585.3 crore in FY2022 and q-o-q growth of ~10% in Q1FY2023 over Q4FY2022. This was aided by significant traction in the high-luxury segment which grew to ~28% in 9MFY2022 as compared to ~19% in FY2021. Further, company's increasing portfolio of exclusive brand sales augur well for further growth and profitability. The company's focus towards increasing offline channel during the pandemic added further push to the revenue growth.

Successful completion of IPO in May 2022 for subsidiary Ethos Limited – Ethos recently concluded its IPO with the total offer size of Rs 402.3 crore, out of which Rs 375 crore was the proceeds from fresh issue. With the IPO proceeds, Ethos Limited has repaid all its debt except for public deposits, which has also reduced to approx. Rs 10 crore now. Further, the IPO proceeds are to be primarily utilized towards funding stock across an expanded store network over the next few years and also in the existing stores to fuel further growth. As of now, Ethos holds healthy liquidity from the funds raised, out of which the amount earmarked for capex is expected to be deployed in a gradual manner, in line with availability of retail space from identified real estate developers.

Improvement in financial risk profile, coverage metrics to remain healthy – With significant increase in the top line and improved profitability, overall financial risk profile of the company has improved. Higher proportion of exclusive brand sales, lower discounts offered in the second half of FY2022 and better absorption of overheads, the company posted operating profit of Rs 93 crore translating into operating margin of 15.8% and margin of 4.0% in FY2022. Over FY2021 and FY2022, the company received lease rental concessions which supported margins and would not be available going forward, however healthy demand is expected to support the company's margins. Although, the gearing remained healthy at 0.70 times as on March 31st, 2022, it will improve significantly given the entire prepayment of debt in June-July 2022 from the IPO proceeds. Going forward, with entire debt getting paid and no major debt raising plans as capex will also be executed through IPO funds, the coverage indicators are expected to be healthy.

Established market position –Ethos Limited, is the largest organised luxury watch retailing company in the country and operates out of its 50 stores spread across India as of June 2022 and is planning to expand further. The amount earmarked for the capex out of entire IPO proceeds will be utilized towards opening 13 new stores and for renovation of 6 stores, which will further increase company's visibility across the country. Rest of the amount would be utilized towards working capital and repayment of debt

Credit challenges

High working capital requirements – The company's working capital intensity remained high at ~33% in FY2022 and ~37% in FY2021, given the luxury watches inventory to be maintained in stores, necessitating high working capital funding. Also, with the IPO concluding and Ethos expected to increase its footprints in the country with 13 new stores planned along with increasing high value and excusive brand sales, the overall inventory requirement will remain high. However, Ethos has dedicated funds earmarked for the same purpose in its IPO proceeds. While there are no working capital bank limits, Ethos is expected to maintain adequate liquidity for its funding requirements. This apart, the company has repaid all its bank debts and will have to fund its working capital entirely from its internal accruals.

Risk of fluctuating demand – The company's performance is directly dependent on demand which mainly relies on the discretionary spending of the consumers. The demand in retail business also remains prone to regulatory headwinds like changes in government policies regarding taxation, etc. Further the company is exposed to competition from domestic players and international markets in retail and other global manufacturers in the component segment. Current global scenario in Europe may have a dampening effect on both i.e., supply and demand in the near to medium term and may adversely impact the overall outlook for the company.

Exposed to forex risks – The company is exposed to forex fluctuations as substantial number of watches are procured from the foreign market.

Environmental and Social Risks

Environmental Considerations – Ethos does not face any major physical climate risk. The company is into retail and could face the tightening environmental regulations with regard to non-efficient usage of power and energy, which can lead to an increase in pollution levels and escalate costs. High electricity consumption and high usage of air conditioning may cascade to higher operational cost for the company. The company through installation of LED lights & power saving equipment across the stores and optimum use of air conditioner (AC) at all office is trying to reduce the high electricity consumption.

Social Considerations – Exposure to social risks is moderate for the retail sector. With a relatively high requirement of workforce for store operations, the level of wages and associated fixed costs could weigh on margins, especially given the skilled nature of the job involved in retailing of luxury and high luxury products. Furter, the company strictly prohibits employment or engagement of child force at work place and expects that its vendors also follow the same.

Liquidity position: Adequate

Ethos's liquidity position is **adequate** on account of the sufficient cash generation from its business to manage its working capital requirements. There are modest repayments towards public deposits which is to the tune of Rs 10 crore as majority of the amount has been repaid out of internal accruals. The company had cash levels of ~Rs. 38 crore as on March 31, 2022. While Ethos has sizeable capex plans, it is expected to be met by funds earmarked for the same from the IPO proceeds.

Rating sensitivities

Positive factors – Significant improvement in its scale with better profitability and healthy liquidity position will be considered for a rating improvement. Significant improvement in the credit profile of the parent may also trigger a rating upgrade.

Negative factors – Deterioration in the parent's credit profile can lead to a rating downgrade. Negative pressure on the ratings could emerge if there is a dip in demand, leading to pressure on revenues and profitability. Stretch in working capital cycle and pressure on liquidity may also warrant a rating review.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Policy on Withdrawal of Credit Ratings
Parent/Group Support	The rating of Ethos takes into consideration it's position as part of the KDDL Group. KDDL along with its wholly owned subsidiary holds a controlling stake of ~61% in Ethos. The current rating of Ethos does not include any uplift by virtue of its parentage.
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the standalone financials of Ethos Limited.

About the company

KDDL's subsidiary Ethos was incorporated in 2003. Ethos is engaged in retailing luxury watches. It retails 50 premium and luxury watch brands such as Omega, Jaeger LeCoultre, Panerai, Bvlgari, H. Moser & Cie, Rado, Longines, and Tissot, etc. The company runs 50 retail stores across 17 cities in India, including New Delhi, Mumbai, Bengaluru, Hyderabad, Chennai and Kolkata. Ethos was recently listed in May 2022. Ethos Limited has 7,000 different premium watches and 30,000 watches in stock at any given time. Ethos Limited was recently listed in the month of May 2022.

Key financial indicators (Audited)

Standalone	FY2020 (A)	FY2021 (A)	FY2022 (A)
Operating income	457.8	400.6	585.3
PAT (Rs. crore)	0.04	4.76	23.39
OPBDIT/OI (%)	12.0%	14.1%	15.8%
PAT/OI (%)	0.0%	1.2%	4.0%
Total outside liabilities/Tangible net worth (times)	1.76	1.45	1.14
Total Debt/OPBDIT (times)	3.18	2.48	1.74
Interest coverage (times)	2.33	2.84	4.32

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

Status of non-cooperation with previous CRA: CRISIL migrated the company's ratings to 'CRISIL FB+ (Stable) ISSUER NOT COOPERATING' on December 31, 2020; on best available information with the credit rating agency.

https://www.crisil.com/mnt/winshare/Ratings/RatingList/RatingDocs/Ethos_Limited_December_31_2020_RR.html

Any other information: None

Rating history for past three years

S.No.	Instrument	Current Rating (FY2023)					Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding as on March 31, 2022	Current Rating	Current Rating	FY2022	FY2021	FY2020	
					25-Oct-22	9-Jun-22	8-Dec-21	8-Dec-20	7-Jan-20	10-May-19
1	Fund-based/Cash Credit	Long-term	56.00	0.00	[ICRA]A-(Stable); Withdrawn	[ICRA]BBB+(Positive);	[ICRA]BBB+(Positive);	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund-based/Term loan	Long-term	3.65	0.00	[ICRA]A-(Stable); Withdrawn	[ICRA]BBB+(Positive);	[ICRA]BBB+(Positive);	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Non-fund Based	Short-term	5.35	0.00	[ICRA]A2+; Withdrawn	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
4	Unallocated	Long-term/Short-term	5.00	0.00	[ICRA]A-(Stable)/ [ICRA]A2+; Withdrawn	[ICRA]BBB+(Positive) /[ICRA]A2	[ICRA]BBB+(Positive) /[ICRA]A2	[ICRA]BBB+(Stable)/ [ICRA]A2	-	-
5	Fixed Deposits	Long-term	10.00	10.00	[ICRA]A-(Stable);	[ICRA]BBB+(Positive)	MA-(Positive)	MA- (Stable)	MA-(Stable)	MA-(Stable)

Amount in Rs. crore

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund-based/Cash Credit	Simple
Fund-based/Term loan	Simple
Non-fund Based	Very Simple
Unallocated	NA
Fixed Deposits	Very Simple

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: www.icra.in

Annexure-1: Instrument details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Fund-based/Cash Credit	-	NA	-	56.00	[ICRA]A-(Stable); Withdrawn
NA	Fund-based/Term loan	FY2021	NA	FY2025	3.65	[ICRA]A-(Stable); Withdrawn
NA	Non-fund Based	-	NA	-	5.35	[ICRA]A2+; Withdrawn
NA	Unallocated	-	NA	-	5.00	[ICRA]A-(Stable)/[ICRA]A2+; Withdrawn
NA	Fixed Deposits	-	NA	-	10.0	[ICRA]A-(Stable);

Source: *Company*

Annexure-2: List of entities considered for consolidated analysis – Not applicable

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