Ethos Limited

April 03, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Cash Credit	51.00	56.00	[ICRA]BBB (Stable); Reaffirmed
Fund based – Term Loans	3.65	3.65	[ICRA]BBB (Stable); Reaffirmed
Non Fund based – Bank Guarantee	5.35	5.35	[ICRA]A3+; Reaffirmed
Fixed Deposits	22.00	22.00	MA- (Stable); Outstanding
Total	**82.00**	**87.00**	

Rating action

ICRA has reaffirmed the long-term rating of [ICRA] BBB (pronounced ICRA triple B) to the Rs. 59.65-crore[1] (enhanced from Rs 54.65 crore) fund-based limits of Ethos Limited (Ethos[2]). ICRA has also reaffirmed the short-term rating of [ICRA]A3+ (pronounced ICRA A three plus) on the Rs. 5.35-crore non fund-based limits of Ethos. The outlook on the long-term rating is 'stable'. ICRA also has an outstanding medium-term rating of [ICRA] MA- (pronounced ICRA M A minus) on the Rs. 22.00-crore fixed deposits programme of Ethos. The outlook on the medium-term rating is 'Stable'. For arriving at the rating, ICRA has combined the business and financial risk profiles of Ethos and its parent company KDDL Limited (KDDL).

Rationale

The rating reaffirmation favourably factors in Ethos' reputed position as luxury watch retailer and KDDL's established market position in watch component manufacturing as a leading supplier of watch components to global watch majors. The rating also draws comfort from the group's modest leverage, ability to raise equity and the continued financial support available to Ethos from KDDL. The ratings, however, are constrained by the continued pressures on Ethos' growth and margins led by impact of regulatory changes on demand. In addition, the company's funding requirements continue to be high on account of substantial stock levels which along with recent net losses have resulted into modest return indicators.

Going forward, the company's ability to improve its operating performance and generate sizeable profits will continue to be a key rating sensitivity. Further, KDDL's ability to ramp up its returns over its recently expanded scale so as to maintain coverage metrics will be crucial. This apart, the promoters' ability to bring in the planned equity and maintain liquidity position will also be a rating monitorable.

[1] *100 lakh = 1 crore = 10 million*

[2] *For complete rating scale and definitions, please refer to ICRA's website www.icra.in or other ICRA Rating Publications*

Outlook: Stable

ICRA believes that Ethos will continue to benefit from KDDL's support via equity infusion which helps in addressing debt obligation amid weak operating indicators. ICRA also believes improvement in demand scenario post rationalisation of GST in the luxury watches segment will support demand revival. The outlook may be revised to 'Positive' in case of substantial growth in demand along with improvement in profitability margins. The outlook however may be revised to 'Negative' if the demand remains stagnant and the margins deteriorate from the current levels leading to weaker coverage. Given the high working capital intensive nature of operations, any stretch in working capital cycle or if any sudden increase in capital expenditure will also lead to 'Negative' outlook. ICRA will continue to monitor the impact of import duty increase from 10% to 20% on the demand for luxury watches.

Key rating drivers

Credit strengths

Established market position as luxury watch retailer – Ethos has an established market position and manages the largest retail chain of luxury watches in the domestic organised sector. The company has exclusive brand partnerships along with a good product mix (medium range watches to high-value luxury watches). Over the years, Ethos has built a network of 41 stores across cities such as Ahmedabad, Chandigarh, New Delhi, Hyderabad, Mumbai, Pune, Lucknow etc. among many others.

Consistent support from KDDL and shareholders – Parent KDDL has been consistently raising equity (~Rs 31 crore over last three FYs) which along with cash accruals has helped Ethos company to fund its losses and manage its liquidity cycle. The promoters are supposed to bring in further RS 5 crore by March 31, 2018. Ethos has also raised FDs over the last few years and has Rs 11.6 crore of outstanding FD as on September 30, 2017. In the current year too, the company has invited tenders to raise additional FDs amounting to Rs 22 crore. ICRA notes that the actual repayments in the FD scheme have been lower than scheduled, with majority of the amount being renewed (as also witnessed in KDDL). Any substantial increase in this outflow will need support from KDDL, pending improvement in Ethos' own cash accruals.

Modest indebtedness – The group has a consolidated networth of Rs 67.24 crore and a total debt of Rs 65.55 crore respectively as on September 30, 2017 resulting in a modest leverage of 0.97 as on as on September 30, 2017. The same is supported by reserve accretion in KDDL's manufacturing operations and regular equity infusion.

Credit challenges

Slower-than-expected revival in performance – FY2017 has been a very challenging year for Ethos due to weak operating performance, which was impacted by multiple regulatory changes over the last eight quarters. The luxury watch segment has witnessed lots of headwinds from PAN guidelines in January 2016 and the requirement for tax collection at source (TCS) for all cash transactions above Rs. 0.3 crore in July 2016. Demonetisation in November 2016, subsequent announcement in the Union Budget that cash transactions above Rs. 0.2 crore would be banned and imposition of the highest GST on the segment added to the challenges. However, the revision of GST from 28% to 18% on the watch segment has supported demand revival in Q3 FY2018, which also coincides with the strongest quarter for the company due to festivals and wedding seasons. Ethos has witnessed a revenue growth of 4% year on year (YoY) in 9M FY2018.

High working capital requirements – The retail business has high working capital requirements owing to high levels of inventory spread across stores. Ethos' working capital intensity stood at 34% in FY2017 and 34% in H1FY2018. Ethos' working capital limits also witnessed very high utilizations over the last few quarters.

Weak return and coverage metrics – The capital structure of Ethos remained moderate owing to cash losses in the last two years, which has resulted in some erosion of the company's net-worth position. Weak margins have led to weak debt coverage indicators. In view of the inadequate cash accruals, weak DSCR has remained a credit concern, the company is however getting funding support from the parent company KDDL at regular intervals to furnish debt obligation. As on March, 2017 the DSCR stood at 0.39x on account of additional payment of short term loan of Rs 4 crore and as on September 30, 2017, the DSCR stood at 0.01x on account of payment of redeemable preference shares to KDDL amounting to Rs 3 crore. However, ICRA notes that on a consolidated level, the coverage indicators remained moderate as characterized by interest coverage of 1.9x, DSCR of 1.08x, total debt/ OPBIDTA of 4.22x and NCA/ total debt of 10% in FY2017. As on September 30, 2017, the coverage indicators stood moderate as reflected by interest coverage of 2.3x, DSCR of 1.3x, total debt/ OPBIDTA of 4.04x and NCA/ total debt of 12%.

Analytical approach: For arriving at the ratings, ICRA has applied its rating methodologies as indicated below.

Links to applicable criteria:

Impact of Parent or Group Support on an Issuer's Credit Rating

Financial Consolidation and Rating Approach

About the company:

Incorporated in 2003, Ethos operates India's largest retail chain of luxury watches, which has 41 stores as on January 02, 2018 at various locations in India. The group company KDDL manufactures watch components such as dials and hands and has a presence in Switzerland through its subsidiary, Pylania SA, which also makes dials and hands for Swiss watch companies. As on September 30, 2017, SAIF (a qualified institutional buyer) held 16.27% equity stake in KDDL.

On a consolidated basis, the group reported a net profit of Rs. 0.08 crore on an operating income of Rs. 455.4 crore in FY2017, as compared to a net profit of Rs. 10.5 crore on an operating income of Rs. 449.8 crore in the previous year. In 9MFY2018, the group on a consolidated basis reported revenue of Rs. 364.1 crore as compared to Rs 350.4 crore in 9MFY2017.

Ethos on standalone basis reported a loss of Rs. 7.5 crore on an operating income of Rs. 325.7 crore in FY2017, as compared to a net loss of Rs. 5.9 crore on an operating income of Rs. 327.2 crore in the previous year. In 9MFY2018, the company reported revenue of Rs. 259.8 crore as compared to Rs 250.0 crore in 9MFY2017.

Key financial indicators (Audited)

	FY2016	FY2017
Operating Income (Rs. crore)	327.2	325.7
PAT (Rs. crore)	-5.9	-7.5
OPBDIT/ OI (%)	1.8%	1.6%
RoCE (%)	3.1%	2.6%
Total Debt/ TNW (times)	1.2	1.1
Total Debt/ OPBDIT (times)	12.2	12.8
Interest Coverage (times)	0.7	0.5
NWC/ OI (%)	33%	34%

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years

	Instrument	Type	Current Rating (FY2019) Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating April 2018	Chronology of Rating History for the past 3 years: Date & Rating in FY2018 January 2018	Date & Rating in FY2018 April 2017	Date & Rating in FY2017
1	Term Loans	Long Term	3.65	3.65	**[ICRA] BBB (Stable)**	**[ICRA] BBB (Stable)**	**[ICRA] BBB (Stable)**	**-**
2	Overdraft	Long Term	56.00	56.00	**[ICRA] BBB (Stable)**	**[ICRA] BBB (Stable)**	**[ICRA] BBB (Stable)**	**-**
3	Bank Guarantee	Short Term	5.35	5.35	**[ICRA] A3+**	**[ICRA] A3+**	**[ICRA] A3+**	**-**
4	Fixed Deposits	Medium Term	22.00	22.00	**MA- (Stable)**	**MA- (Stable)**	**-**	**-**

Complexity level of the rated instrument

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the 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
	Term Loans	2014	NA	2022	3.65	[ICRA] BBB (Stable)
	Overdraft	NA	NA	NA	56.00	[ICRA] BBB (Stable)
	Bank Guarantee	NA	NA	NA	5.35	[ICRA] A3+
	Fixed Deposits	NA	NA	NA	22.00	MA- (Stable)

Source: Ethos

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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.

Today, ICRA and its subsidiaries together form the ICRA Group of Companies (Group ICRA). ICRA is a Public Limited Company, with its shares listed on the Bombay Stock Exchange and the National Stock Exchange. The international Credit Rating Agency Moody's Investors Service is ICRA's largest shareholder.

For more information, visit www.icra.in

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