Ethos Limited

September 28, 2018

Summary of rated instruments

Instrument	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund based – Cash Credit	56. 00	56.00	[ICRA]BBB+ (Stable); Upgraded from [ICRA] BBB (Stable)
Fund based – Term Loans	3.65	3.65	[ICRA]BBB+ (Stable); Upgraded from [ICRA] BBB (Stable)
Non-fund based – Bank Guarantee	5.35	5.35	[ICRA]A2; Upgraded from [ICRA] A3+
Fixed Deposits	22.00	22.00	MA- (Stable); Outstanding
Total	**87.00**	**87.00**	

Rating action

ICRA has upgraded the long-term rating to [ICRA]BBB+ (pronounced ICRA triple B plus) from [ICRA]BBB (pronounced ICRA triple B) on the Rs. 33.0-crore fund-based facilities and short-term rating to [ICRA]A2 (pronounced ICRA A two) from [ICRA]A3+ (pronounced ICRA A three plus) on the Rs. 12.0-crore non-fund based facilities of KDDL Limited (KDDL)[1]. The outlook on the long-term rating is Stable. ICRA also has an outstanding medium-term rating of MA- (pronounced M A minus) on the Rs. 22.00-crore fixed deposit 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 upgrade takes into account the demand revival post-GST[2] revision to 18% from 28%, which is further supported by tie-up with 14 exclusive principal manufacturers leading to the Group's improved profitability margins and coverage indicators. The rating also takes support from the healthy equity infusion of Rs. 24.0 crore from the various individual investors in the current year, coupled with the parent company's planned equity infusion of Rs. 26.00 crore to support the future capex and working capital obligations. Further, the ratings continue to draw comfort from KDDL's established market position, in watch component manufacturing, as a leading supplier of watch hands and dials to global watch majors and Ethos' repute as a luxury watch retailer. Moreover, given the Group's ability to increase its equity base regularly, the capital structure was moderate despite its debt-funded capex in manufacturing and the high working capital intensive business of Ethos.

The ratings, however, are constrained by the demand risk in luxury watch retail division post increase of import duty to 20% from 10%. Additionally, the impact of rupee depreciation remains to be seen in Ethos, where 55% of the inventory is imported. In addition, the Ethos' funding requirements continue to be high on account of substantial stock levels, which along with past losses have resulted into high dependence on KDDL's support. ICRA further notes the substantial capex plans in Ethos and the gestation period associated with build-up of sales volume may somewhat impact the Group's return indicators and coverage metrics.

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

[2] *GST = Goods and Service Tax*

Going forward, Ethos' ability to sustain its operating performance and generate sizeable profits and KDDL's ability to ramp up its returns over its recently expanded scale to maintain the coverage metrics will be crucial. Further, KDDL's promoters' ability to infuse the planned equity into Ethos and support its liquidity position and working capital requirements will be a rating monitorable. ICRA notes that the Group has plans to list Ethos and will continue to monitor the development.

Outlook: Stable

ICRA believes that Ethos will continue to benefit from KDDL's support via equity infusion, which helps in addressing its capex and working capital obligations. ICRA further believes that the improvement in the demand scenario post rationalisation of GST in the luxury watches segment will support the demand revival. The outlook may be revised to Positive in case of substantial growth in revenues in the coming quarters along with improvement in profitability margins on a consolidated basis. The outlook, however, may be revised to Negative in case if the demand remains stagnant and the margins deteriorate from the current levels leading to weaker coverage and delay in ramping up of the precision engineering segment. Furthermore, any delay in bringing the planned equity in Ethos and its probable impact on the liquidity or pressure on cash flows will also be a credit negative.

Key rating drivers

Credit strengths

Improved operating metrics post demand revival and stable regulatory scenario – The rating favourably factors in the company's revenue growth post demand revival from Q3 FY2018. It registered a 10% growth in its operating income (OI) in FY2018 on a year-on-year (YoY) basis. This apart, it witnessed a revenue growth of 2% in Q1 FY2019 from the previous corresponding period. At the consolidated level, the retail business has contributed around 71% to the overall revenue in FY2018 and owing to the growing revenue of Ethos, on a consolidated basis, the OI has registered 11% growth as compared to the subdued growth in the previous year. On a consolidated basis, the company has a net worth of Rs. 161.65 crore (including minority interest of Rs 29.66 crore) and a total debt of Rs. 138.0 crore as on March 31, 2018, resulting in a modest leverage of 0.9 times as on the same date.

Post demand revival in Ethos, the operating metrics improved as depicted by a gearing of 0.7 times, NCA/Debt of 13% and interest coverage of 1.7 times as on March 31, 2018. Further with improved performance in Ethos, the consolidated indicators also improved as characterised by NCA/Debt of 19%, DSCR of 1.4 times and interest coverage of 3.6 times as on March 31, 2018.

Consistent support from KDDL and shareholders – KDDL, the parent entity, has been consistently infusing equity into Ethos (~Rs. 46.56 crore over the last three FYs) and has helped the company to fund its past losses and manage its liquidity cycle. In the current year too, Ethos has raised Rs. 24.0 crore from various shareholders and KDDL is supposed to bring in further Rs. 26.0 crore by March 31, 2019, which will support its large capex plans and help in servicing debt obligations. Ethos has also raised FD[3]s over the last few years and has Rs. 18.1crore of outstanding FD as on March 31, 2018. ICRA notes that the actual repayments in the FD scheme have been lower than scheduled, with most of the amount being renewed (as also witnessed in KDDL). Any substantial increase in this outflow will need support from KDDL and Ethos' own cash accruals.

[3]FD = Fixed Deposits

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 44 stores as on Q1 FY2019 across cities such as Ahmedabad, Chandigarh, New Delhi, Hyderabad, Mumbai, Pune, Lucknow etc among many others.

Credit challenges

Demand risk in retail business post import duty hike and rupee depreciation – In the retail business, Ethos' operating metrics improved post revision in GST to 18% from 28%. However, sustainability of the current demand amid an increase in the custom duty to 20% from April 2019 from the earlier 10% is a key monitorable. Further, the impact of the rupee depreciation on Ethos remains to be seen. ICRA also notes that the demand in luxury watches is highly discretionary, with technological and obsolescence risk in watches also resulting in moderate inventory risk.

Substantial planned capex in Ethos – The company has planned for expansion of its network to 65 stores in the next three years from the current 44 stores. Given the gestation period for a build-up in the sales volume, the expansion in the new cities could impact the Group's return indicators and coverage metrics. ICRA will monitor its ability to ramp up the scale and achieve break-even associated with the new stores.

High working capital requirements – The retail business has high working capital requirements owing to its high levels of inventory spread across stores and the working capital intensity stood at 34% in FY2018. Ethos' working capital limits also witnessed high utilisation over the last 12 months. However, KDDL has been consistently supporting Ethos to manage its liquidity cycle. KDDL's own working capital requirement is also substantial, as indicated by its working capital intensity of 30% in FY2018 due to high debtor and inventory level on account of the start of the new brownfield unit of precision.

Pending ramp up of capex in manufacturing segment – Aided by good traction in precision engineering, KDDL has undertaken a brownfield expansion in precision engineering to add new capacity. ICRA notes that part operations of the new unit began from August 2018. However, a higher gestation period will be required for ramping up of the entire unit.

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

Links to applicable criteria:
Corporate Credit Rating Methodology

Financial Consolidation and Rating Approach

About the company

Incorporated in 2003, Ethos operates India's largest retail chain of luxury watches with 44 stores as on Q1 FY2019 at various locations in India. The Group company, KDDL [rated [ICRA] BBB+ (Stable)/A2/MA- (Stable)], manufactures watch components such as dials and hands and has presence in Switzerland through its subsidiary, Pylania SA, which also makes dials and hands for Swiss watch companies. As on June 31, 2018, SAIF (a qualified institutional buyer) held 15.72% equity stake in KDDL.

On a consolidated basis, the Group reported a net profit of Rs. 18.36 crore (after minority interest and other comprehensive income) on an OI of Rs. 501.75 crore in FY2018 compared with a net profit of Rs. 1.25 crore (after minority interest and other comprehensive income) on an OI of Rs. 453.23 crore in the previous year. In Q1 FY2019, the Group (on a consolidated basis) reported revenues of Rs. 147.19 crore compared with Rs. 122.84 crore in Q1 FY2018.

Ethos, on standalone basis, reported a net profit of Rs. 4.04 crore (after other comprehensive income) on an OI of Rs. 355.36 crore in FY2018 compared to a net loss of Rs. 6.24 crore (after other comprehensive income) on an OI of Rs. 324.36 crore in the previous year. In Q1 FY2019, it reported revenue of Rs. 100.80 crore compared with Rs .99.10 crore in Q1 FY2018.

Key financial indicators (Audited) - Standalone

	FY2017	FY2018
Operating Income (Rs. crore)	324.4	355.4
PAT (Rs. crore)*	-6.24	4.04
OPBDIT/OI (%)	1.2%	4.6%
RoCE (%)	2.1%	10.3%
Total Debt/TNW (times)	1.1	0.7
Total Debt/OPBDIT (times)	17.7	3.9
Interest Coverage (times)	0.3	1.7

* after other comprehensive income

Status of non-cooperation with previous CRA: Not Applicable

Any other information: KDDL is rated [ICRA] BBB+ (Stable)/ A2and [ICRA] MA- (Stable)

Rating history for last three years

	Instrument	Current Rating (FY2019) Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating September 2018	Chronology of Rating History for the past 3 years: Date & Rating in FY2018 April 2018	Date & Rating in FY2018 January 2018	Date & Rating in FY2018 April 2017
1	Term Loans	Long Term	3.65	3.65	[ICRA] BBB+ (Stable)	[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)	[ICRA] BBB (Stable)
3	Bank Guarantee	Short Term	5.35	5.35	[ICRA] A2	[ICRA] A3+	[ICRA] A3+	[ICRA] A3+
4	Fixed Deposits	Medium Term	22.00	22.00	MA- (Stable)	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] A2
	Fixed Deposits	NA	NA	NA	22.00	MA- (Stable)

Source: Company

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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.

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