ICRA

May 10, 2019

Ethos Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Cash Credit	56. 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]A2; Reaffirmed
Fixed Deposits	22.00	22.00	MA-(Stable); Reaffirmed
Total	**87.00**	**87.00**	

*Instrument details are provided in Annexure-1

Rationale

For arriving at the ratings, ICRA has combined the business and financial risk profiles of Ethos Limited (Ethos) and its parent company, KDDL Limited (KDDL, rated [ICRA]BBB+(Stable)/[ICRA]A2/[ICRA]MA-(Stable)). The ratings reaffirmation takes into account the continuous demand improvement in Ethos in the last five quarters (Q3 FY2018-Q3 FY2019), further supported by its tie-ups with 14 exclusive principal manufacturers, leading to improved profitability margins. The operating metrics in the business improved owing to change in the business model by implementing lean cost structure and focusing on exclusive brand sales. This led to improvement in the Group's profitability and coverage indicators. The ratings also take support from the healthy equity infusion of Rs. 24 crore from various investors in FY2019, coupled with KDDL's equity infusion of Rs. 5.0 crore, which have supported capex and working capital obligations. 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's reputation as a luxury watch retailer. Given the Group's ability to increase its equity base regularly, the capital structure was moderate despite its debt-funded capex towards manufacturing and Ethos's high working capital intensive business.

The ratings, however, are constrained by demand risk in the retail division as luxury watches are highly discretionary and have high elastic demand. Additionally, the impact of forex fluctuations remains high in the retail division given 40% of the inventory is imported. Ethos's 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. Further, the Group's coverage indicator, as characterised by DSCR, stood moderate given net losses over FY2016-FY2017, gradual revival in Ethos, and high debt obligation in the manufacturing business (owing to debt-funded capex in the last four fiscals). ICRA further notes that 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.

Going forward, Ethos's 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 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 will continue to monitor the demand impact with increase in the import duty by 10% in the retail division.

Outlook: Stable

ICRA expects Ethos to continue to benefit from KDDL's support via equity infusion, which helps in addressing its capex and working capital obligations. ICRA further believes that rationalisation of Goods and Services Tax (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 the demand remains stagnant, the margins deteriorate from the current levels (leading to weaker coverage) and if there is a delay in the ramping up of the precision engineering segment. Furthermore, any delay in bringing the planned equity into Ethos and its probable impact on liquidity or a pressure on the cash flows will be a credit negative.

Key rating drivers

Credit strengths

Improved operating metrics post demand revival - The company's revenue grew post demand revival from Q3 FY2018, and it registered a 31% growth in operating income (OI) in 9M FY2019 on a year-on-year (YoY) basis. At the consolidated level, the retail business contributed ~71% to the overall revenue. Owing to Ethos's increasing revenue, on a consolidated basis, the OI registered a 30% growth in 9M FY2019 compared to previous year. On a consolidated basis, the company had net worth of Rs. 229.03 crore (including minority interest of Rs. 42.39 crore) and total debt of Rs. 117.5 crore as on December 31, 2018, resulting in a modest leverage of 0.5 time on the same date.

Post demand revival in Ethos, the operating metrics improved as depicted by gearing of 0.5 time, NCA/Debt of 28% and interest coverage of 4.2 times as on December 31, 2018. Further, with improved performance in Ethos, the consolidated profitability margins improved, as characterised by operating profit margins of 11.6% and net margins of 4.7% as on December 31, 2018.

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 47 stores (as on March 2019) across cities such as Ahmedabad, Chandigarh, New Delhi, Hyderabad, Mumbai, Pune, Lucknow etc.

Healthy YoY equity infusion from KDDL and shareholders - KDDL, the parent entity, has consistently infused equity into Ethos (~Rs. 58.9 crore till FY2019) and helped the company fund its past losses and manage its liquidity cycle. In the current year too, Ethos raised Rs. 29.0 crore from various shareholders as well as KDDL. Further, in FY2020, ICRA expects KDDL to bring in further equity, which will support its sizeable capex plans and help in servicing debt obligations. Ethos also raised FD[1]s from shareholders over the last few years and had Rs. 11.7 crore of outstanding FDs as on December 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's own cash accruals.

[1]*FD = Fixed Deposits*

Credit challenges

Demand risk in retail business amid forex fluctuations and regulatory changes - The retail business was impacted over FY2016-FY2017 owing to various regulatory headwinds. The operating metrics, however, improved post revision in GST to 18% from 28%. The sustainability of demand remains a key monitorable as luxury watches are highly discretionary and have high elastic demand. Further, the impact of forex fluctuations on Ethos remains high given 40% of the inventory is imported. ICRA also notes that inventory risk is moderate in luxury watches owing to technological and obsolescence risks.

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 47 stores. Given the gestation period for build-up of the sales volume, the expansion in the new cities may impact the Group's return indicators and coverage metrics. ICRA will monitor its ability to ramp up scale and achieve break-even associated with the new stores.

Modest coverage and return indicators of the group - Aided by good traction in precision engineering, KDDL has undertaken a brownfield expansion in the segment to add new capacity. ICRA notes that complete operations of the new unit began from February 2019. However, due to pending ramp-up of the utilisation, the return indicators were modest in 9M FY2019. Further, higher gestation period will be required for the ramping up of the entire unit. The Group's coverage indicator as characterised by DSCR (1.4x and 1.3x as on March 31, 2018 and December 31, 2018, respectively) stood moderate, given net losses over FY2016-FY2017, gradual revival in the retail business, and high debt obligation in the manufacturing business. However, ICRA notes that the actual low repayment outflows on deposit liabilities have eased the pressure on DSCR.

High working capital requirements - The retail business has high working capital requirements owing to the high levels of inventory spread across stores, with the working capital intensity at 34% in FY2018. Ethos's working capital limits also witnessed high utilisation over the last 12 months. However, KDDL has consistently supported 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 levels, on account of the start of its new brownfield precision unit.

Liquidity position

The free cash flows remained negative due net cash losses in the past and continuous capex requirements YoY, which primarily were met through equity infusion from KDDL and others. Ethos's liquidity position is stressed given the high working capital dependence with weak cash accruals in the past. However, the promoters and other non-promoter groups have continuously infused funds into the business to ease liquidity pressure. ICRA notes the Group's demonstrated ability for raising fresh borrowings or refinancing existing borrowings regularly from market as well banks. Ethos's free cash levels as on December 31, 2018 stood at Rs. 8.5 crore.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Parent Company: KDDL Limited Ratings derive comfort from the strengths enjoyed by the company being part of the KDDL group by way of funding support
Consolidation/Standalone	Consolidated financial statements.

About the company

Incorporated in 2003, Ethos operates India's largest retail chain of luxury watches with 47 stores in FY2019 across the country. The Group company, KDDL, 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 March 31, 2019, SAIF (a qualified institutional buyer) held 15.15% equity stake in KDDL.

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 against 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 9M FY2019, the Group reported revenues of Rs. 478.1 crore against Rs. 370.5 crore in 9M FY2018.

Ethos, on standalone basis, reported a net profit of Rs. 4.0 crore on an OI of Rs. 355.4 crore in FY2018, compared with a net loss of Rs. 6.2 crore on an OI of Rs. 324.4 crore in the previous year. In 9M FY2019, the company reported a net profit of Rs. 9.1 crore on an OI of Rs. 340.3 crore, compared with a net profit of Rs. 1.4 crore on an OI of Rs. 260.4 crore in 9M FY2018.

Key financial indicators (audited)

	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

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

		Current Rating (FY2020)				Chronology of Rating History for the past 3 years			
	Instrument	**Type**	**Amount Rated (Rs. crore)**	**Amount Outstanding (Rs. crore)**	**Date & Rating May 2019**	**Date & Rating in FY2019 September 2018**	**Date & Rating in FY2019 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)**	**[ICRA] BBB (Stable)**
2	Overdraft	Long Term	56.00	56.00	**[ICRA] BBB+ (Stable)**	**[ICRA] BBB+ (Stable)**	**[ICRA] BBB (Stable)**	**[ICRA] BBB (Stable)**	**[ICRA] BBB (Stable)**
3	Bank Guarantee	Short Term	5.35	5.35	**[ICRA] A2**	**[ICRA] A2**	**[ICRA] A3+**	**[ICRA] A3+**	**[ICRA] A3+**
4	Fixed Deposits	Medium Term	22.00	22.00	**MA- (Stable)**	**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	2024	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

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership as March 31, 2019	Consolidation Approach
KDDL Limited	72.5%	Full Consolidation
Ethos Limited	72.5%	Full Consolidation

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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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