September 20, 2022

Pothys (Chennai): [ICRA]A(Stable); assigned

Summary of rating action

Instrument*	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Term Loans	13.08	[ICRA]A(Stable); assigned
Long-term Unallocated	10.42	[ICRA]A(Stable); assigned
Total	**23.50**	

**Instrument details are provided in Annexure-1*

Rationale

While arriving at the ratings, ICRA has consolidated the business and financial profiles of Pothys Private Limited (PPL), Pothys Retail Private Limited (PRPL), Pothys Chennai (PC), Pothys Tirunelveli (PT) and Pothys Swarna Mahal Private Limited (PSMPL) together referred to as the 'Pothys Group' given the significant operational and financial linkages among them and the common management.

The assigned rating factors in the established brand name of the Pothys Group and extensive experience of the promoters in the textile industry. With 18 textile stores operating across Tamil Nadu, Kerala, Karnataka and Puducherry, Pothys is a well-known brand in South India, retailing varied product categories including silk sarees, readymade garments for men, women and kids, electronics and grocery products, among others. Owing to its long presence in the textile industry, the Group has a strong procurement channel, enabling it to buy products from a diverse set of suppliers at competitive rates. This in turn has resulted in consistent high gross margins of 32-35% over the last three years, with an operating profit margin (OPM) of 14-16%. The financial profile of the Group is comfortable, marked by low gearing and healthy debt coverage indicators.

The performance of the Indian retail sector was adversely impacted in FY2021 and FY2022, following the Covid-19 pandemic and subsequent Government-mandated shutdown of malls as well as non-essential stores and reduced discretionary spends. Pothys Group reported a 49% decline in revenues in FY2021 at Rs. 1,449 crore, which improved to Rs. 2,818 crore in FY2022, following easing of restrictions and increasing vaccination coverage. In FY2022, the Group ventured into jewellery retail business by setting up two stores through its wholly-owned subsidiary, PSMPL. PSMPL plans to scale up its operations by setting up three new stores for which incremental working capital financing would be required. Besides additional working capital limits from banks, ~Rs. 150-160 crore of additional investment towards funding requirement is expected to be provided by textile business to PSMPL. Quick and profitable ramp up of operations of jewellery business remains a monitorable.

The rating is also constrained by the Group's asset-heavy business model, wherein it purchases the space rather than leasing it. This in turn entails large capital expenditure (capex) towards store additions. The Group is in the process of setting up three new stores each in the textile and jewellery segment over the next three to four years at a total outlay of ~Rs. 500 crore, proposed to be funded via debt of ~Rs. 300 crore. Timely ramp-up of these stores would be key rating monitorable. The Group also remains exposed to the risk of geographical concentration as ~70% of the revenues are derived from Tamil Nadu. Further, the Group's revenues and profitability are exposed to intense competition in the retail industry, which is characterised by the presence of several organised and unorganised players.

The Stable outlook on [ICRA]A rating reflects ICRA's opinion that the Pothys Group will benefit from its established brand name and extensive experience of its promoters in the textile industry.

Key rating drivers and their description

Credit strengths

Established brand name, experienced management – The Pothys Group has strong presence in South India, especially Tamil Nadu, where it enjoys a healthy market position in the apparel retail market and is the leading player in silk garments. Over the last four decades, the Group has expanded to 18 textile showrooms in 13 cities spread across Tamil Nadu, Kerala, Karnataka, and Puducherry. Established brand name of Pothys ensures strong footfalls, thereby driving its revenue growth. The promoters have over three decades of experience in the textile industry.

Strong procurement channel; consistent high gross margins – The Pothys Group has a strong procurement channel wherein it procures products from a diverse set of suppliers at competitive rates. Coupled with the established brand name of Pothys, this resulted in high gross margins of 32-35% during the last three fiscals, with OPMs in the range of 14-16%. Such high gross margins support the overall financial profile of the Group.

Comfortable financial profile – The Group's financial profile is comfortable, supported by low gearing and strong coverage indicators. Despite the adverse impact of the pandemic on the Group's performance in FY2021 and FY2022, the overall financial profile (although moderated from the historical levels) continued to remain comfortable as the Group was able to maintain its profit margins on the back of reduction in salary and selling expenses. The Group's gearing stood at 1.0 time as on March 31, 2022 (as per provisional estimates), with an interest coverage ratio of 5.0 times in FY2022 (as per provisional estimates) compared to 4.0 times in FY2021. The net debt-to-operating profit ratio stood at 2.7 times as on March 31, 2022 (as per provisional estimates) compared to 3.3 times as on March 31, 2021. The promoters have also advanced interest-free unsecured loans worth ~Rs. 110 crore as on March 31, 2022 (as per provisional estimates) that do not have a definite repayment date and are expected to be retained in the business indefinitely. Going forward, the overall financial profile is likely to improve, supported by demand recovery, ramp-up of operations of two stores opened in 2021 and expected healthy cash accruals in the business despite high debt-funded capex.

Credit challenges

Asset heavy business model – From 2014, the Pothys Group adopted an asset-heavy business model, wherein it purchases the space rather than leasing it, given the operational convenience and flexibility. This entails large capex towards store additions. The Group has incurred huge debt-funded capex of over Rs. 500 crore over the last five years for setting up new stores, which resulted in an increase in the debt levels. The Pothys Group added two new textile showrooms in 2021 in Chrompet (Tamil Nadu) and Ernakulam (Kerala). Further, it is setting up new textile stores in Chennai, Kancheepuram and Tirupur (Tamil Nadu) and jewellery stores in Trivandrum, Trichy and Chennai (Tamil Nadu) over FY2023-FY2026, which will entail a total capex of ~Rs. 500 crore, to be funded by ~60% debt and ~40% internal accruals. Quick ramp-up of operations of the new stores remains critical. ICRA, however, takes comfort from the Group's track record of ramping up operations of new stores and achieving break-even in the first year itself. Pothys Group diversified into jewellery retailing business in FY2022 by setting up two stores. It plans to scale up the operations by setting up three new stores over the next three to four years. Quick and profitable ramp up of operations of jewellery business while maintaining the credit profile remains a monitorable.

Geographical concentration risk – Around 70% of the Group's revenues are derived from stores in Tamil Nadu every year. The Group operates 14 textile stores in Tamil Nadu, one in Karnataka, two in Kerala and one in Puducherry. Further, it plans to open three new stores in Tamil Nadu. The jewellery stores are also in Tamil Nadu. This leads to the risk of geographical concentration for the Group and renders the revenue growth and profitability susceptible to market conditions in Tamil Nadu.

Intense competition in the retail business – The textile and jewellery retailing business is characterised by stiff competition with presence of several organised and unorganised players, which restricts the pricing flexibility. Additionally, the demand for discretionary products like apparel and jewellery is susceptible to economic cycles. Further, the business requires continual spend on brand promotions to support brand recall and drive footfalls.

Liquidity position: Adequate

The Group's liquidity position is **adequate** supported by headroom available in the form of unutilised bank limits. The Group's (excluding jewellery business) average utilisation of the fund-based limits stood at 59% during April 2021 to June 2022, reflecting average unutilised limits of Rs. 122.4 crore (with adequate drawing power). For the jewellery business, the average utilisation of the fund-based limits stood high at 95% during September 2021 to June 2022 due to stocking of inventory at new stores and given the nascent stage of operations. The consolidated cash flows in the textile and jewellery business in FY2023 and FY2024 are likely to improve to Rs. 350-400 crore in FY2023 and FY2024 and are expected to be sufficient to meet the debt repayment obligations of Rs. 143 crore in FY2023 and Rs. 95 crore in FY2024. In addition to proposed working capital limits of ~Rs. 500 crore from banks (not sanctioned), the jewellery business will receive Rs. 150-160 crore funding support from the textile business. The Group plans to set up three new showrooms each for the textile and jewellery in the next three to four years, which will entail a capex of ~Rs. 500 crore, to be funded by 60% debt and 40% internal accruals.

Rating sensitivities

Positive factors – ICRA could upgrade the ratings if the Group is able to report a healthy growth in revenues and profits while maintaining a comfortable credit profile and liquidity position. Net debt-to-operating profit ratio remaining below 1.5 times on a sustained basis will be a positive factor.

Negative factors – Pressure on the Group's ratings could arise if there is a significant decline in sales or a deterioration in the earnings adversely impacting the financial profile. A significant debt-funded capex or a stretch in the working capital cycle, which adversely impacts the debt coverage indicators so that the interest cover remains below 5.0 times on a sustained basis would be a negative factor.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Entities in the Retail Industry Rating Methodology for Entities in the Gems and Jewellery (Retail) Industry Consolidation and Rating Approach
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has consolidated the business and financial profiles of Pothys Private Limited, Pothys Retail Private Limited, Pothys Chennai (Firm), Pothys Tirunelveli (Firm) and Pothys Swarna Mahal Private Limited given the significant operational and financial linkages among them and common management.

About the company

Founded in 1923, Pothys is a chain of textile showrooms operating in South India, mainly Tamil Nadu. The Pothys Group has 18 textile showrooms in 13 cities spread across Tamil Nadu, Kerala, Karnataka, and Puducherry to sell cotton and silk sarees, readymade garments, other garments, electronics, and home utility products. The Chennai Group under PPL comprises 10 showrooms across Chennai (four), Coimbatore (two), Bengaluru (one), Puducherry (one), Salem (one) and Chrompet (one). The Tirunelveli Group under PRPL comprises eight showrooms across Tirunelveli (two), Madurai (one), Srivilliputhur (one), Trichy (one), Nagercoil (one), Trivandrum (one) and Ernakulam (one). Pothys Chennai and Pothys Tirunelveli hold assets that are used by PPL and PRPL, respectively, for their business operations and do not have any showrooms operating under them. PSMPL retails jewellery under the brand Pothys and operates two showrooms in Tirunelveli and Chrompet.

Key financial indicators (Consolidated*)

	FY2021 (Audited)	FY2022 (Provisional)
Operating Income (Rs. Crore)	1,449.1	2,818.3
PAT (Rs. Crore)	99.4	214.5
OPBDIT/OI (%)	15.9%	14.1%
PAT/OI (%)	6.9%	7.6%
Total Outside Liabilities/Tangible Net Worth (times)	1.4	1.4
Total Debt/OPBDIT (times)	3.6	2.8
Interest Coverage (times)	4.0	5.0

Source: Pothys Group; PAT: Profit after Tax; OPBDIT: Operating Profit before Depreciation, Interest, Taxes and Amortisation
All ratios are as per ICRA's calculations
**Includes financials of PPL, PRPL, PC, PT, PSMPL*

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

	Instrument	Current Rating (FY2023)				Chronology of Rating History for the past 3 years		
		Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating in FY2023	Date & Rating in FY2022	Date & Rating in FY2021	Date & Rating in FY2020
					20-Sep-2022	-	-	-
1	Fund-based Term Loans	Long-term	13.08	13.08*	[ICRA]A (Stable)	-	-	-
2	Unallocated	Long-term	10.42	-	[ICRA]A (Stable)	-	-	-

**as on August 31, 2022*

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based Term Loans	Simple
Long-term Unallocated	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, is 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	Term Loans	FY2018	6.50 - 8.75%	FY2033	13.08	[ICRA]A(Stable)
NA	Unallocated	-	-	-	10.42	[ICRA]A(Stable)

Source: *Company*

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

Annexure – 2: List of entities considered for consolidated analysis

Sr.	Entity Name	Consolidation Approach
1	Pothys Private Limited	Full consolidation
2	Pothys Retail Private Limited	Full consolidation
3	Pothys Chennai (Firm)	Full consolidation
4	Pothys Tirunelveli (Firm)	Full consolidation
5	Pothys Swarna Mahal Private Limited	Full consolidation

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