

September 25, 2023

Pothys (Tirunelveli): Rating reaffirmed; rated amount enhanced

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Long-term Fund-based Term Loans	96.15	132.61	[ICRA]A(Stable); reaffirmed/assigned
Long-term Unallocated	0.12	-	-
Total	96.27	132.61	

*Instrument details are provided in Annexure-I

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), KVPS Property Developers Private Limited (KVPS), Pothys Swarna Mahal Private Limited (PSMPL) and Otto Clothing Private Limited (OCPL), together referred to as the Pothys Group, given the significant operational and financial linkages among them and the common management.

The 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 products 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 retail business of 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 a consistent high gross margin of 32-35% over the last four years, with an operating profit margin (OPM) of 13-16%.

In FY2023, the Group reported revenues of Rs. 4,930 crore (as per provisional estimates; reflecting a YoY revenue growth of 52%), supported by a pick-up in discretionary spending, post easing of pandemic related restrictions, ramp-up of new stores under the textile retail division as well as ramp-up of operations of the newly commenced jewellery business. The financial profile of the Group is comfortable, as reflected in a gearing of 0.9 times as on March 31, 2023 (previous year [P.Y.] – 1.1 times), net debt-to-operating profit ratio of 2.2 times as on March 31, 2023 (P.Y. – 2.5 times) and an interest cover of 6.5 times in FY2023 (P.Y. – 5.0 times). Going forward, the financial profile is expected to remain comfortable, supported by a steady growth in the textile business and continued ramp-up of the jewellery business despite huge debt-funded capital expenditure (capex) plans.

The rating is constrained by the Group's asset-heavy business model, wherein it purchases the space rather than leasing it. This in turn entails large capex towards store additions. The Group is in the process of setting up three new stores in the textile and two stores in the jewellery segment over the next three years at a total outlay of ~Rs. 500 crore, proposed to be funded via debt of ~Rs. 400 crore. Healthy ramp-up of these stores in a timely manner amid intense competition in the industry would be key rating monitorable. The Group also remains exposed to the risk of geographical concentration as 60-70% of the revenues is derived from Tamil Nadu. Further, the Group's revenues and profitability are exposed to intense competition in the retail industry (textile and jewellery), which is characterised by the presence of several organised and unorganised players. Besides, the working capital intensity of operations for the retail jewellery business remains high primarily due to high inventory holding period inherent to the nature of the business as well as the nascent stage of operations.

The Stable outlook on [ICRA]A rating reflects ICRA's opinion that the credit profile of the Pothys Group will remain adequately supported by the steady cash flow generation in the textile business, benefitting 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 in the textile retail business – The textile retail business of the Pothys Group has a strong procurement channel, wherein it procures products from a diverse set of suppliers at competitive rates. Along with the established brand name of Pothys, this has resulted in a high gross margin of 32-35% during the last four fiscals, with OPM in the range of 13-16%. Such high gross margin supports the overall financial profile of the Group.

Healthy ramp-up of operations of the jewellery business – In FY2022, Pothys Group ventured into the jewellery retail business by setting up two stores through its wholly-owned subsidiary, PSMPL. It added one store in FY2023. Despite limited track record and intense competition in the market, PSMPL reported revenues of Rs. 482 crore in FY2022 and Rs. 750 crore in FY2023 (as per provisional estimates). In the current fiscal, the jewellery business reported sales of Rs. 412 crore in 4M FY2024 (as per provisional estimates). Besides healthy ramp-up of operations, the company remained profitable at the operating and net levels.

Comfortable financial profile – In FY2023, the Group reported revenues of Rs. 4,930 crore (as per provisional estimates; reflecting a YoY revenue growth of 52%) supported by a pick-up in discretionary spending post easing of pandemic-related restrictions, ramp-up of new stores under the textile retail division as well as ramp-up of operations of the newly commenced jewellery business. The OPM declined to 12.6% in FY2023 (as per provisional estimates) from 15-16% during the previous three years. Nevertheless, the overall financial profile remained comfortable (supported by limited capex outgo and controlled working capital cycle), as reflected in a gearing of 0.9 times as on March 31, 2023 (P.Y. – 1.1 times), net debt-to-operating profit ratio of 2.2 times as on March 31, 2023 (P.Y. – 2.5 times) and an interest cover of 6.5 times in FY2023 (P.Y. – 5.0 times). Despite headwinds in the form of reduced discretionary spending (due to inflationary pressure), healthy sales momentum continued in the current fiscal with the Group reporting sales of ~Rs. 1,900 crore in 4M FY2024 (as per provisional estimates). This was supported by strong brand recall, customer loyalty, diversified product offering, among others. Going forward, the financial profile is expected to remain comfortable, supported by a steady growth in the textile business and continued ramp-up of the jewellery business despite huge debt-funded capex plans.

Credit challenges

Asset heavy business model, large capex plans – 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. 600 crore over the last six years for setting up new stores, which resulted in an increase in the debt level. 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 (Tamil Nadu) and Tirupati (Andhra Pradesh) and jewellery stores in Trichy and Chennai (Tamil Nadu) over FY2024-FY2026, which will entail a total capex of ~Rs. 500 crore and would keep free cash flows under check, to be funded by debt of ~Rs. 400 crore and the balance through 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 breakeven in the first year itself.

Working capital intensive nature of operations of the jewellery retail business – PSMPL's working capital intensity of operations, as reflected by the net working capital vis-à-vis the operating income (NWC/OI), remained high in the range of 60-70% in FY2022 and FY2023 (as per provisional estimates) primarily due to a high inventory holding period inherent to the

nature of the business as well as the nascent stage of operations. PSMPL plans to scale up its operations by ramping up the existing stores and setting up two new stores for which incremental working capital financing would be required. Besides additional working capital limits from banks, additional investment towards funding requirement is expected to be provided by the textile business to PSMPL. A further ramp-up of operations of the jewellery retail business along with an improvement in the profitability and thereby the overall credit profile, would be monitored.

Geographical concentration risk; intense competition in the retail business – Around 70% of the Group's revenues (of textile retail business) is derived from stores in Tamil Nadu every year. The Group operates 14 textile retail 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 and one in Andhra Pradesh over the medium term. 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.

The textile and jewellery retailing businesses are characterised by stiff competition with presence of several organised and unorganised players, which restricts pricing flexibility. Additionally, demand for discretionary products like apparel and jewellery is susceptible to economic cycles. Further, the business requires continuous spend on promotional activities to support brand recall and drive footfalls. This would keep the margins under check.

Liquidity position: Adequate

The Group's liquidity position is **adequate** supported by strong cash generation in the textile business and headroom available in the form of unutilised bank limits. The Group's (excluding jewellery business) average utilisation of the fund-based limits stood at 64% during April 2022 to July 2023, reflecting average unutilised limits of Rs. 110 crore (with adequate drawing power) during the said period. For the jewellery business, the average utilisation of the fund-based limits stood high at 95% during April 2022 to July 2023 due to stocking of inventory at new stores and because of the nascent stage of operations. The consolidated fund flow from operations in the textile and jewellery business in FY2024 and FY2025 is likely to improve to Rs. 400-500 crore. These are expected to be deployed towards incremental working capital requirements (mainly for jewellery business), equity funding for capex and will be sufficient to meet the debt repayment obligations of Rs. 102 crore in FY2024 and Rs. 103 crore in FY2025. Besides additional working capital limits from banks, the jewellery business will receive funding support from the textile business. The Group plans to set up three new showrooms for the textile and two new showrooms for the jewellery division in the next three to four years, which will entail a capex of ~Rs. 500 crore, to be funded by debt of ~Rs. 400 crore. Besides, resourcefulness of the promoters supports the liquidity position of the Group. The same is evident from the promoter's regular fund infusion in the business through unsecured loans.

Rating sensitivities

Positive factors – ICRA could upgrade the rating 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 rating could arise if there is a significant decline in sales or a deterioration in the earnings, adversely impacting its financial profile. A significant debt-funded capex or a stretch in the working capital cycle, which adversely impacts the debt coverage indicators such 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
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the rating, ICRA has consolidated the business and financial profiles of Pothys Private Limited, Pothys Retail Private Limited, Pothys Chennai (Firm), Pothys Tirunelveli (Firm), Pothys Swarna Mahal Private Limited, KVPS Property Developers Private Limited and Otto Clothing 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 showroom operating under them. PSMPL retails jewellery under the brand, Pothys, and operates three showrooms in Tirunelveli, Chrompet and Trivandrum (Tamil Nadu). KVPS, a subsidiary of PPL, is an SPV undertaking construction of a new showroom alongwith PPL.

Key financial indicators (Consolidated)

	FY2022 (Audited)	FY2023 (Provisional)
Operating Income	3,242.5	4,930.0
PAT	259.3	374.6
OPBDIT/OI	15.4%	12.6%
PAT/OI	8.0%	7.6%
Total Outside Liabilities/Tangible Net Worth (times)	1.6	1.4
Total Debt/OPBDIT (times)	2.6	2.3
Interest Coverage (times)	5.0	6.5

Source: Company; PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore
All ratios as per ICRA calculations; consolidation is done basis best available information after netting of related party transactions

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for past three years

Instrument		Current rating (FY2024)			Chronology of rating history for the past 3 years			
		Type	Amount rated (Rs. Crore)	Amount outstanding (Rs. Crore)	Date & rating in FY2024	Date & rating in FY2023	Date & rating in FY2022	Date & rating in FY2021
					25-Sep-2023	20-Sep-2022	-	-
1	Fund-based Term Loans	Long-term	132.61	132.61*	[ICRA]A(Stable)	[ICRA]A(Stable)	-	-
2	Unallocated	Long-term	-	-	-	[ICRA]A(Stable)	-	-

*as on June 30, 2023

Complexity level of the rated instruments

Instrument	Complexity Indicator
Long-term Fund-based Term Loans	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: [Click Here](#)

Annexure I: Instrument details

ISIN	Instrument Name	Date of Issuance	Coupon Rate	Maturity	Amount Rated (Rs. Crore)	Current Rating and Outlook
NA	Term Loans	FY2018	8-9%	FY2029	132.61	[ICRA]A(Stable)

Source: Company

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Annexure II: 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
6	KVPS Property Developers Private Limited	Full consolidation
7	Otto Clothing Private Limited	Full consolidation

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