

January 07, 2020

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	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 taken a consolidated view of KDDL Limited (KDDL) and its subsidiaries and associate companies, given the strong operational, financial and managerial linkages between these companies.

The rating reaffirmation continues to positively factor in KDDL's established market position in watch component manufacturing as a leading supplier of watch hands and dials, catering to a significant portion of Swiss watch demand and about ~100% of the domestic watch hands market. The ratings take into account the company's established relationships with leading luxury watch manufacturers in the world like Swatch, Tag Heuer, Gucci, Edox, etc resulting in repeat business from the clients. The ratings also favourably factor in the company's comfortable capital structure, aided by regular equity infusion. ICRA also takes note of the year-on-year (Y-o-Y) growth of 24.4% in consolidated revenues in FY2019 aided by strong demand in the watch components manufacturing business along with new store additions in the retail division. The Y-o-Y growth in H1 FY2020, however decelerated to 2.8%, primarily on account of contraction of sales in the retail division due to overall weak consumer sentiment, which was also exacerbated by the low supply of some key brands due to global supply shortages

The ratings are constrained by the group's high working capital intensity of 31.3% in FY2019 given the high raw material and work in progress inventory carrying requirement in its manufacturing division and high finished good inventory stocking in its retail division, necessitating high working capital funding. Further, ICRA takes note of the group's modest coverage indicators, as characterised by TD/OPBITDA of 2.36 times and DSCR of 1.18 times in FY2019 (TD/OPBITDA of 3.54 times and DSCR of 1.26 times in H1 FY2020) given the modest profitability in the retail division and debt-funded capex undertaken in the manufacturing division in the past, resulting in increased debt levels. Further, demand risk in the retail division remains as the spend on luxury watches is highly discretionary and there is high demand elasticity. Additionally, the impact of forex fluctuations remains high in the retail division, as a large part of the inventory is imported.

Going forward, the group's ability to demonstrate improvement in revenues and profitability, thereby resulting in improvement in return indicators, will be the key rating monitorable.

Key rating drivers

Credit strengths

Established market position - KDDL has an established market position in watch component manufacturing as a leading supplier of watch hands and dials catering to a significant portion of Swiss watch demand and established relationships

with leading luxury watch manufacturers in the world like Swatch, Tag Heuer, Gucci, Edox, etc resulting in repeat business from the clients. Further, its retail arm, Ethos, is a well-known player in luxury watch retailing in the country operating out of its 53 stores spread across India.

Comfortable capital structure amid improved profitability in FY2019 - In the retail segment, the operating metrics have 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 in FY2019. On a consolidated basis, the group had a modest leverage of 0.66 times as on March 31, 2019. The revival in Ethos' performance post Q3 FY2018 has resulted in improvement in consolidated indicators. ICRA also draws comfort from the group's liquidity profile as indicated by moderate utilisation of bank limits, margin money maintained for fixed deposit repayments and moderate level of free cash balances.

Group's liquidity supported by renewal of fixed deposits and ability to raise funds on a regular basis from market – On a consolidated basis, fixed deposits from shareholders amounted to Rs. 28.77 crore as on March 31, 2019 (~18.7% of debt outstanding) and Rs. 27.50 crore as on September 30, 2019. A significant proportion of these are renewed, thereby supporting the liquidity position. Further, the group has a demonstrated track record of raising equity from the market which imparts strong financial flexibility.

Credit challenges

High working capital requirements - The working capital intensity of the group is high at ~31.3% in FY2019 given the huge raw material and work in progress inventory in its manufacturing vertical and high finished good inventory in its retail division, necessitating high working capital funding. That said, the group has sufficient cushion in the form of drawing power and utilisation averaged at ~60% in KDDL and ~85% in Ethos during the past eight-month period ending November 2019.

Modest coverage and return indicators - The group's coverage indicators as characterised by TD/OPBITDA of 2.36 times and DSCR of 1.18 times in FY2019 (TD/OPBITDA of 3.54 times and DSCR of 1.26 times in H1 FY2020) remain modest given the low profitability in the retail division and debt-funded capex undertaken in the manufacturing division in the past resulting in increased debt levels.

Demand risk in retail business amid regulatory changes - The retail business remains exposed to regulatory headwinds like mandatory PAN requirement for transactions exceeding Rs.2.0 lakh in January 2016, tax collection at source implemented in June 2016, demonetisation of high value currency in November 2016, increase in customs duty on imported watches to 20% in February 2018. The sustainability of demand remains a key monitorable as spend on luxury watches is highly discretionary and there is high demand elasticity.

Exposed to forex risks - The impact of forex fluctuations remains high since a major portion of KDDL's revenues are dependent on exports (Swiss market) and a large portion of retail purchases are imports from Switzerland resulting in forex exposure. That said, the group's forex gains amounted to Rs. 1.16 crore in FY2019 (0.2% of revenues and 1.8% of OPBITDA).

Liquidity position - Adequate

The liquidity position of the group is adequate given the cash balances of Rs. 18.0 crore (of which Rs. 12.01 crore is in the form of free cash) as on Sept 30, 2019. Also, the utilisation on the fund based limits is low at ~60% in KDDL and moderate at ~85% in Ethos, providing adequate buffer. The repayment obligations for FY2020 stood at Rs. 29.72 crore (of which bank debt obligations of Rs. 9.51 crore), which can be met through the projected cash flow from operations. The liquidity also derives support from the renewal of deposits by various stakeholders, in the past.

Rating sensitivities

Positive triggers – The ratings could be upgraded if the group demonstrates significant improvement in profitability and working capital cycle on a sustained basis. Specific credit metrics that could result in an upgrade include ROCE of greater than 16% on a sustained basis.

Negative triggers – Negative pressure on the ratings could emerge if there is higher than anticipated debt funded capex, or elongation in working capital cycle. Specific credit metrics that could trigger a downgrade include TD/OPBITDA above 3 times on a sustained basis.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating Methodology for Retail
Parent/Group Support	Not applicable
Consolidation/Standalone	Consolidated

About the company

Incorporated in 2003, Ethos operates India's largest retail chain of luxury watches operating out of its 53 stores as on September 2019 at various locations in India.

Key financial indicators

	Ethos			Consolidated		
	FY2018	FY2019	H1 FY2020	FY2018	FY2019	H1 FY2020
Operating Income (Rs. crore)	356.1	442.4	208.8	501.7	624.2	314.1
PAT (Rs. crore)	4.0	11.2	-2.8	18.2	25.2	-1.3
OPBDIT/OI (%)	4.8%	7.5%	11.0%	8.8%	10.5%	12.4%
RoCE (%)	10.3%	16.5%	4.6%	14.3%	16.9%	7.1%
Total Outside Liabilities/Tangible Net Worth (times)	1.67	1.21	1.97	1.63	1.17	1.95
Total Debt/OPBDIT (times)	3.72	2.32	4.17	3.12	2.36	3.54
Total Debt (excluding FD, ICDs, Lease)/OPBDIT (times)	2.66	1.71	1.53	2.30	1.70	1.67
Interest Coverage (times)	1.79	3.02	2.53	3.55	4.40	2.84
DSCR	1.07	1.15	1.64	1.38	1.18	1.26

Status of non-cooperation with previous CRA:

CRISIL has migrated the ratings to 'CRISIL FB+ (Stable) Issuer not cooperating' on December 26, 2019; on best available information with the credit rating agency.

https://www.crisil.com/mnt/winshare/Ratings/RatingList/RatingDocs/Ethos_Limited_December_26_2019_RR.html

Any other information:

Disclosure: A Member of the Board of Directors of ICRA Limited is also an Independent Director on the Board of Directors of KDDL Limited (KDDL). This Director was not involved in any of the discussions and processes related to the Rating of the instrument(s) mentioned herein.
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Rating history for last three years

		Current Rating (FY2020)				Chronology of Rating History for the past 3 years			
		Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2017	
									Instrument
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	Cash Credit	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]A2	[ICRA]A3+	[ICRA]A3+
4	Fixed Deposits	Medium Term	22.00	22.00	MA- (Stable)	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
NA	Term Loans	2019	-	-	3.65	[ICRA]BBB+ (Stable)
NA	Cash Credit	NA	11.50%-13.80%	NA	56.00	[ICRA]BBB+ (Stable)
NA	Bank Guarantee	NA	NA	NA	5.35	[ICRA]A2
NA	Fixed Deposits	NA	9.00%-12.50%	NA	22.00	MA- (Stable)

Source: Company

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
KDDL Limited	-	Full Consolidation
Subsidiaries		
Ethos Limited	75.36%	Full Consolidation
Pylania SA	85.00%	Full Consolidation
Kamla International Holdings SA	100.00%	Full Consolidation
Mahen Distribution Limited	98.72%	Full Consolidation
Satva Jewellery and Design Limited	100.00%	Full Consolidation
Cognition Digital LLP	100.00%	Full Consolidation
Kamla Tesio Dials Limited	30.00%	Full Consolidation
Estima AG	100.00%	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.

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