

October 25, 2022

KDDL Limited: Rating upgraded; outlook revised to Stable

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based/ Cash Credit	27.0	27.0	[ICRA]A-(Stable); upgraded from [ICRA]BBB+(Positive), outlook revised to Stable from Positive
Fund-based/ Term Loan	36.68	36.68	[ICRA]A-(Stable); upgraded from [ICRA]BBB+(Positive), outlook revised to Stable from Positive
Non-fund Based	25.00	25.0	[ICRA]A2+; upgraded from [ICRA]A2
Fund-based	3.00	3.00	[ICRA]A2+; upgraded from [ICRA]A2
Fixed Deposits	15.00	15.00	[ICRA]A-(Stable); upgraded from [ICRA]BBB+(Positive), outlook revised to Stable from Positive
Total	106.68	106.68	

*Instrument details are provided in Annexure-1

Rationale

The rating upgrade factors in the improvement in KDDL Limited's (KDDL/ the company) consolidated performance, led by revival in demand witnessed by the manufacturing segment and ICRA's expectations of further strengthening of credit metrics led by healthy order book visibility for manufacturing and retail network expansion. Moreover, increase in sales of high value units has supported expansion in the company's margins which is expected to continue further. The same remains supported by KDDL's prominent market position in watch component manufacturing as a leading supplier of watch hands and dials, and established relationships with leading global luxury watch manufacturers. In addition, the retail business under its subsidiary, Ethos Limited¹, has continued to witness significant sales traction at all its stores after the subsiding of the pandemic. While Ethos' stores network grew in FY2022, its recent successful IPO positions it well for achieving growth through store expansion. The rating favourably factors in Ethos' position as the largest organised luxury watch retailer in the country. Moreover, on a consolidated basis, the company's credit metrics have improved with better accruals.

The ratings, however, are constrained by the susceptibility of the watch components business's volatility in the global economy, which may adversely impact global demand and adversely impact both supply and demand particularly in the luxury and high luxury segment. Additionally, the company is exposed to forex fluctuation risk for both its manufacturing as well as retail businesses. Moreover, the business remains working capital intensive led by high inventory requirements in retail along with moderate inventory and debtors at the manufacturing level. Nevertheless, ICRA notes that the retail business shall be shoring up its inventory through equity funds in the medium term, in line with the specified purpose of IPO funds. Nonetheless, the company is exposed to competition from domestic players and international markets in retail and other global manufacturers in the component segment.

¹ KDDL continues to hold 51% in Ethos, following the latter's IPO.

Key rating drivers and their description

Credit strengths

Improved demand across manufacturing as well as retail segment – After subdued performance in FY2021 in both manufacturing as well as retail divisions, the company witnessed revival in FY2022. In the manufacturing division, the company witnessed stable demand both in the domestic as well as export segments. Although there was limited increase in sales volumes, higher demand of high-value units along with favourable forex movement helped the company in scaling up significantly. KDDL has a healthy order visibility, particularly in the watch component export and precision engineering segments, which will help it register steady growth in the current fiscal as well. In the luxury watches retail segment, the local demand grew with the company achieving revenue growth of ~46% from Rs. 400.6 crore in FY2021 to Rs. 585.3 crore in FY2022. In addition, the company witnessed significant traction in the high luxury segment, which grew to ~28% in 9M FY2022 over ~19% in FY2021. Further, its increasing portfolio of exclusive brand sales augurs well for further growth and profitability. The company's focus towards increasing offline channel sales during the pandemic further push up its revenue growth. On a consolidated basis, the company's revenue increased by 46% from Rs. 562.8 crore to Rs. 824.3 crore. In Q1 FY2023, the company witnessed a QoQ growth of ~10% and ~9.5% in manufacturing and retail, respectively, resulting in a consolidated growth of ~5%.

Successful completion of IPO in May 2022 for subsidiary, Ethos – Ethos recently concluded its IPO with a total offer size of Rs. 402.3 crore, of which proceeds from the fresh issue stood at Rs. 375 crore. Ethos has repaid all its debt, barring public deposits, from its IPO proceeds. Further, the IPO proceeds are to be primarily utilised towards funding stock across an expanded store network over the next few years. As of now, Ethos holds healthy liquidity from the funds raised, which is expected to be deployed in a gradual manner, in line with availability of retail space from identified real estate developers.

Improvement in financial risk profile, coverage metrics to remain healthy – With significant increase in the top line and improved profitability, the company's overall financial risk profile has improved. At a consolidated level, supported by high value-added sales, higher proportion of exclusive brand sales and better absorption of overheads at Ethos' level, the company posted operating profit of Rs. 120 crore, translating into an operating margin of 14.6% and net profit margin of 4.5% in FY2022. While the operating margin remained stagnant, due to reduction in lease rental concessions, the net margin increased from 1.2% in FY2021. This apart, the gearing improved to 0.86 time as on March 31, 2022 from 1.1 times as on March 31, 2021 largely on account of limited debt utilisation and better internal accrual generation. Interest coverage and TD/OPBIDTA improved from 2.73 times and 3.03 times, respectively, in FY2021 to 4.0 times and 2.2 times in FY2022, respectively. Going forward, with Ethos' debt being repaid from its IPO proceeds and no major debt raising plans from KDDL, the coverage indicators are likely to remain healthy.

Established market position – KDDL has a prominent market position in watch component manufacturing as a leading supplier of watch hands and dials, having established relationships with leading luxury watch manufacturers in the world like Swatch, Tag Heuer, Gucci, Edox, etc. Further, its subsidiary Ethos is the largest organised luxury watch retailing company in the country and operates from 50 stores spread across India, as of June 2022.

Credit challenges

High working capital requirements – The company's working capital intensity remained high at ~29% in FY2022 and ~33% in FY2021, given the raw material and work-in-progress inventory and moderate receivable period in its manufacturing vertical along with high luxury watches inventory maintained in its stores. Also, with the IPO concluding and Ethos expected to increase its footprints in the country with 13 new stores, along with increasing high-value and exclusive brand sales, the overall inventory requirement will remain high. However, Ethos has dedicated funds earmarked for the same from its IPO proceeds. For manufacturing, KDDL has sufficient cushion in the form of drawing power and utilisation and company also maintains healthy free cash balances for its funding requirements.

Risk of fluctuating demand amid ongoing global scenario – The company's performance is directly dependent on demand across both its business segments, which mainly relies on discretionary consumer spending. While the company has depicted

growth in the recent past, the evolving nature of the economy and the situation prevailing in European markets might adversely impact the overall market sentiments. The demand in retail business also remains prone to regulatory headwinds such as changes in government policies regarding taxation. Further, the company is exposed to competition from domestic players and international markets in the retail business and other global manufacturers in the component business.

Exposed to forex risks – The company is exposed to forex fluctuations as it is a net exporter and a major portion of KDDL's revenues are dependent on exports (Swiss market). For Ethos, as approximately 40% of its watches are imported with nil exports, the company remains exposed to foreign currency fluctuation risk.

Environmental and Social Risks

Environmental Considerations – KDDL does not face any major physical climate risk. The company is into manufacturing of watch hands and dials and generally, the products generally do not harm the environment or is of any concern to the climate. However, the company could face the tightening environmental regulations with regard to non-efficient usage of power and energy, which can lead to an increase in pollution levels and escalate costs. High electricity consumption and high usage of air conditioning may cascade to higher operational cost for the company. The company through installation of LED lights & power saving equipment across the stores and optimum use of air conditioner (AC) at all office is trying to reduce the high electricity consumption.

Social Considerations – With a relatively high requirement of workforce in the manufacturing as well as retail operations, there are moderate levels of social risk. Further, the company strictly prohibits employment or engagement of child force at work place and expects that its vendors also follow the same.

Liquidity position: Adequate

KDDL's liquidity position is **adequate** on account of the cushion available in its working capital limit and sufficient cash generation from its business to manage its working capital requirements and debt repayments. The company had cash levels of ~Rs. 52 crore as on March 31, 2022, on a consolidated level. Also, the company had an average working capital fund-based utilisation of ~28% in the last 11-months ending in June 2022. For the company, in the near to medium term, the repayments are modest as compared to the internal accruals and free cash available. While it has sizeable capex plans, a predominant share of the same is expected to be funded internally.

Rating sensitivities

Positive factors – The ratings could be upgraded if the Group demonstrates significant improvement in its scale, profitability and working capital cycle on a sustained basis.

Negative factors – Negative pressure on the ratings could emerge if there is a dip in demand, leading to pressure on revenues and profitability. Stretch in working capital cycle and pressure on liquidity may also warrant a rating review. Net Debt/OPBIDTA, i.e., the total debt after excluding the IPO proceeds earmarked for stated purpose, as per issue details, falling lower than 2.0 times, on a sustained basis, might also lead to a rating downgrade.

Analytical approach

Analytical Approach	Comments
Applicable Rating Methodologies	Corporate Credit Rating Methodology
Parent/Group Support	Not applicable
Consolidation/Standalone	For arriving at the ratings, ICRA has considered the consolidated financials of KDDL. The list of companies are given in Annexure-2 . While its subsidiary Ethos was listed recently, at a standalone level, KDDL Limited continues to hold controlling stake at ~52%.

About the company

Incorporated in 1981, KDDL manufactures watch components like dials and hands as well as precision engineering goods under the brand name, Eigen. The company is a leading supplier of high-quality dials and hands to watch manufacturers in India and Switzerland. KDDL enjoys a presence in Switzerland through its subsidiary, Pylania SA & Estima AG, who are engaged in trading and manufacturing dials and hands for Swiss watch companies, respectively.

KDDL's subsidiary Ethos was incorporated in 2003. Ethos is engaged in retailing luxury watches. It retails 50 premium and luxury watch brands such as Omega, Jaeger LeCoultre, Panerai, Bvlgari, H. Moser & Cie, Rado, Longines, and Tissot, etc. The company runs 50 retail stores across 17 cities in India, including New Delhi, Mumbai, Bengaluru, Hyderabad, Chennai and Kolkata. Ethos was recently listed in May 2022.

Key financial indicators (Audited)

Consolidated	FY2020 (A)	FY2021 (A)	FY2022 (A)
Operating income	652.3	562.8	824.3
PAT (Rs. crore)	-2.0	7.0	37.2
OPBDIT/OI (%)	11.9%	14.6%	14.6%
PAT/OI (%)	-0.3%	1.2%	4.5%
Total outside liabilities/Tangible net worth (times)	1.86	1.68	1.36
Total Debt/OPBDIT (times)	3.72	3.03	2.20
Interest coverage (times)	2.73	2.73	4.00

PAT: Profit after tax; OPBDIT: Operating profit before depreciation, interest, taxes and amortisation; Amount in Rs crore

Status of non-cooperation with previous CRA: CRISIL migrated the company's ratings to 'CRISIL FB+ (Stable) ISSUER NOT COOPERATING' on December 31, 2020; on best available information with the credit rating agency.

https://www.crisil.com/mnt/winshare/Ratings/RatingList/RatingDocs/KDDL_Limited_December_31_2020_RR.html

Any other information: A member of the Board of Directors of ICRA Limited is also an Independent Director on the Board of Directors of KDDL Limited. This Director was not involved in any of the discussions and processes related to the Rating of the instrument(s) mentioned herein.

Rating history for past three years

S.N o.	Instrument	Current Rating (FY2023)					Rating History for the Past 3 Years			
		Type	Amount Rated	Amount Outstanding	Current Rating	Current Rating	FY2022	FY2021	FY2020	
					25-Oct-22	9-Jun-22	8-Dec-21	8-Dec-20	7-Jan-20	10-May-19
1	Fund-based/Cash Credit	Long-term	27	27	[ICRA]A - (Stable);	[ICRA]BBB+(Positive);	[ICRA]BBB+(Positive);	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
2	Fund-based/Term loan	Long-term	36.68	36.24	[ICRA]A - (Stable);	[ICRA]BBB+(Positive);	[ICRA]BBB+(Positive);	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)
3	Non-fund Based	Short-term	25	25	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2

4	Fund-based	Short-term	3	3	[ICRA]A2+	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2
5	Fixed Deposits	Long-term	15	15	[ICRA]A - (Stable);	[ICRA]BBB+(Positive);	MA-(Positive)	MA-(Stable)	MA-(Stable)	MA-(Stable)

Amount in Rs. crore

Complexity level of the rated instrument

Instrument	Complexity Indicator
Fund-based/Cash Credit	Simple
Fund-based/Term loan	Simple
Non-fund Based	Very Simple
Fund-based	Simple
Fixed Deposits	Very 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: 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	Fund-based/Cash Credit	-	NA	-	27.00	[ICRA]A-(Stable);
NA	Fund-based/Term loan	FY2018	NA	FY2025	36.68	[ICRA]A-(Stable);
NA	Non-fund Based	-	NA	-	25.00	[ICRA]A2+
NA	Fund-based	-	NA	-	3.00	[ICRA]A2+
NA	Fixed Deposits	-	NA	-	15.0	[ICRA]A-(Stable);

Source: Company

Annexure-2: List of entities considered for consolidated analysis as on March 31, 2022

Company Name	Ownership	Consolidation Approach
KDDL Limited	-	Full Consolidation
Subsidiaries		
Ethos Limited*	61.72%	Full Consolidation
Pylania SA	85.00%	Full Consolidation
Kamla International Holdings SA	100.00%	Full Consolidation
Mahen Distribution Limited	100.00%	Full Consolidation
Satva Jewellery and Design Limited	100.00%	Full Consolidation
Cognition Digital LLP	73.55%	Full Consolidation
Kamla Tesio Dials Limited	69.99%	Full Consolidation
Estima AG	95.50%	Full Consolidation

*For Ethos Limited, the shareholding is of KDDL Limited and other subsidiary as on June 30th 2022.

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About ICRA Limited:

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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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Branches



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