

December 8, 2020 ^{Revised}

KDDL Limited: Ratings reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
Fund-based - Cash Credit	27.00	27.00	[ICRA]BBB+(Stable); Reaffirmed
Fund-based - Term Loans	36.68	36.68	[ICRA]BBB+(Stable); Reaffirmed
Non-fund Based	25.00	25.00	[ICRA]A2; Reaffirmed
Fund based	3.00	3.00	[ICRA]A2; Reaffirmed
Fixed deposits	15.00	15.00	MA- (Stable); Reaffirmed
Total	106.68	106.68	

*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 entities.

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 clients. The ratings also favourably factor in the company's comfortable capital structure, aided by regular equity infusion. ICRA also takes note of the healthy growth in the consolidated revenues—the top line witnessed a CAGR of 9.7% during FY2015–FY2020 and 4% in FY2020 on account of contraction of sales in H2 FY2020 in the manufacturing and retail division owing to the impact of Covid-19 pandemic.

The ratings, however, are constrained by the Group's high working capital intensity of 32.3% in FY2020 and 40.7% in H1 FY2021, 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 impact of Covid-19 pandemic on both manufacturing and retail as Q1 FY2021 remained subdued. Notably, there has been a sharp recovery in Q2 FY2021. ICRA also notes the Group's modest coverage indicators, as characterised by TD/OPBITDA of 3.72 times and DSCR of 1.34 times in FY2020 (TD/OPBITDA of 11.06 times and DSCR of 0.87 times in H1 FY2021), given the modest profitability in the retail division and debt-funded capex undertaken in the manufacturing division in the past, along with impact of IndAS 116 (operating lease liabilities) resulting in increased debt levels. Further, demand risk in the retail division remains on account of high demand elasticity coupled with the discretionary nature of spending for luxury watches. 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, leading to an 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 clients. Further, its retail arm, Ethos, is a well-known player in luxury watch retailing in the country and operates out of its 53 stores spread across India.

Comfortable capital structure; healthy consolidated growth in scale – In the retail segment, the operating metrics have been positively influenced owing to change in the business model by implementing lean cost structure and focusing on exclusive brand sales. On a consolidated basis, the Group had a modest leverage of 0.66 times as on March 31, 2019, which increased to 1.27 times as on March 31, 2020 largely due to IndAS 116 in which lease liabilities constitute as debt, thus pushing the debt levels upward. The revenues have seen a healthy improvement at a CAGR of 9.7% during FY2015–FY2020. 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. 37.33 crore as on March 31, 2020 (~13% of debt outstanding). A significant proportion of these are renewed, 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

Impact of Covid-19 – The consolidated revenues declined by ~57.8% on a quarter-on-quarter (QoQ) basis and ~61.8% on a year-on-year (YoY) basis in Q1 FY2021 due to Covid-19 pandemic and lockdown imposed by Government of India (GoI) which widely affected the retail revenues as the stores remained closed during the lockdown. Thus, a deterioration in scale is expected in FY2021. However, there has been a strong recovery in Q2 FY2021 as the consolidated revenues surged ~148% YoY on the back of recovery of demand, ramp-up of manufacturing operations and opening of almost all stores in Q2 FY2021 amid ease in restrictions by the GoI.

High working capital requirements – The working capital intensity of the Group is high at ~32.3% in FY2020 and 40.7% in H1 FY2021, 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 ~55% in KDDL and 64% in Ethos during the seven-month period ending in July 2020.

Modest coverage and return indicators – The Group’s coverage indicators as characterised by TD/OPBITDA of 3.72 times and DSCR of 1.34 times in FY2020 (TD/OPBITDA of 11.06 times and DSCR of 0.87 times in H1 FY2021), given the modest profitability in the retail division and debt-funded capex undertaken in the manufacturing division in the past, along with impact of IndAS 116 (operating lease liabilities) 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. 0.81 crore in FY2020 (0.1% of revenues and 1.04% of OPBITDA).

Liquidity position - Adequate

The liquidity position of the Group is **adequate**, given the cash balances of Rs. 20.71 crore (of which Rs. 12.93 crore is in the form of free cash) as on September 30, 2020. Also, the utilisation on the fund-based limits is low at ~55% in KDDL and moderate at ~64% in Ethos, providing adequate buffer. 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 its scale, profitability and working capital cycle on a sustained basis.

Negative triggers – Negative pressure on the ratings could emerge, if there is a sustained slowdown due to Covid-19, leading to pressure on revenues and profitability. Further stretch in working capital cycle and pressure on liquidity may also trigger a rating review. A specific credit metric that could lead to a downgrade is TD/OPBITDA higher than 3.5 times (including the impact of operating lease liabilities) 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 1981, KDDL manufactures watch components like dials and hands and 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 has its presence in Switzerland through its subsidiary, Pylania SA, which is engaged in the business of manufacture dials and hands for Swiss watch companies.

Key financial indicators

	Standalone			Consolidated		
	FY2019	FY2020	H1 FY2021	FY2019	FY2020	H1 FY2021
Operating Income (Rs. crore)	176.0	180.6	55.6	625.0	652.3	192.4
PAT (Rs. crore)	15.7	9.1	-4.2	25.2	-2.0	-11.7
OPBDIT/OI (%)	18.14%	16.41%	7.11%	10.38%	11.93%	5.76%
RoCE (%)	13.96%	9.35%	-0.33%	16.73%	7.53%	-0.58%
Total Outside Liabilities/Tangible Net Worth (times)	0.57	0.77	0.78	1.18	1.86	1.77
Total Debt/OPBDIT (times)	1.78	3.03	10.00	2.38	3.72	11.06
Interest Coverage (times)	5.65	3.35	0.82	4.56	2.73	0.80
DSCR	1.43	1.28	0.52	1.19	1.34	0.87

Source: Company

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/KDDL_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.

Rating history for last three years

Instrument	Current Rating (FY2021)			Chronology of Rating History for the past 3 years				
	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs. crore)	Date & Rating	Date & Rating in FY2020		Date & Rating in FY2019	Date & Rating in FY2018
				8-Dec-20	7-Jan-20	10-May-19	28-Sep-18	27-Mar-18
1 Term Loans	Long Term	36.68	36.68	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
2 Cash Credit	Long Term	27.00	-	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB+ (Stable)	[ICRA]BBB (Stable)
3 Bank Guarantee/ Letter of Credit/ Buyer's Credit	Short Term	25.00	-	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A2	[ICRA]A3+
4 Working Capital Demand Loan	Short Term	3.00	-	[ICRA]A2	[ICRA]A2	[ICRA]MA- (Stable)	[ICRA]MA- (Stable)	[ICRA]MA- (Stable)
5 Fixed Deposits	Medium Term	15.00	-	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 [click here](#)

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	2018	9.60%-11.25%	2024	36.68	[ICRA]BBB+ (Stable)
NA	Cash Credit	NA	9.65%-12.15%	NA	27.00	[ICRA]BBB+ (Stable)
NA	Bank Guarantee/ Letter of Credit/ Buyer's Credit	NA	NA	NA	25.00	[ICRA]A2
NA	Working Capital Demand Loan	NA	9.40%	NA	3.00	[ICRA]A2
NA	Fixed Deposits	NA	9.00%-12.50%	NA	15.00	[ICRA]MA- (Stable)

Source: Company

Annexure-2: List of entities considered for consolidated analysis (as on March 31, 2020)

Company Name	Ownership	Consolidation Approach
KDDL Limited	-	Full Consolidation
Subsidiaries		
Ethos Limited	75.56%	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	73.55%	Full Consolidation
Kamla Tesio Dials Limited	30.00%	Full Consolidation
Estima AG	95.50%	Full Consolidation

Source: KDDL's Annual Report

Corrigendum:

Document dated December 8, 2020 has been corrected with revisions as detailed below:

Revisions on page number 3 under “Rating Sensitivities”- “Negative Triggers”: The sentence “A specific credit metrics that could lead to an upgrade is TD/OPBITDA higher than 3.5 times (including the impact of operating lease liabilities) on a sustained basis” has been replaced with “A specific credit metric that could lead to a downgrade is TD/OPBITDA higher than 3.5 times (including the impact of operating lease liabilities) on a sustained basis”.

Analyst Contacts

K. Ravichandran

+91 44 4596 4301

ravichandran@icraindia.com

Manish Ballabh

+91-124-4545 812

manish.ballabh@icraindia.com

Vipin Jindal

+91 124 4545 355

vipin.jindal@icraindia.com

Pankaj Khatri

+91-124-4545327

pankaj.khatri@icraindia.com

Relationship Contact

Jayanta Chatterjee

+91 80 4332 6401

jayantac@icraindia.com

Media and Public Relations Contact

Ms. Naznin Prodhani

Tel: +91 124 4545 860

communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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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

ICRA Limited

Corporate Office

Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002

Tel: +91 124 4545300

Email: info@icraindia.com

Website: www.icra.in

Registered Office

1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001

Tel: +91 11 23357940-50

Branches

Mumbai + (91 22) 24331046/53/62/74/86/87
Chennai + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294
Kolkata + (91 33) 2287 8839 /2287 6617/ 2283 1411/ 2280 0008
Bangalore + (91 80) 2559 7401/4049
Ahmedabad+ (91 79) 2658 4924/5049/2008
Hyderabad + (91 40) 2373 5061/7251
Pune + (91 20) 020 6606 9999

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