INSTITUTIONAL EQUITY RESEARCH

PhillipCapital

Thangamayil Jewellery (TJL IN)

Entering a golden era

28 May 2018

INDIA | RETAIL | Initiating Coverage

Key highlights

- **TJL is one of the leading jewellery players in Tamil Nadu, focused on tier-2 and 3 cities. It is poised to deliver healthy medium-term growth as the troika of demonetisation, GST, and compulsory hallmarking, drive a shift towards organised players.**
- **We expect it to deliver revenue/EBITDA/PAT CAGR of 15%/28%/46% over FY17-20 based on the management's focus on driving volume-led SSS growth, network expansion, favourable product mix, and de-leveraging of its balance sheet through the low-cost gold-on-lease route. ROE should improve to 19% in FY20 from 9.2% in FY17 due to superior operating performance and benefits of using gold on lease.**
- **We initiate coverage with a BUY rating and target of Rs 635 (20x FY20 EPS), a 60% discount to market leader Titan's multiple.**

Focus on volume-led SSS growth: We expect volume-led SSS growth of 15%/12% in FY19/20 on: (1) store refurbishment -- c.60% area in sq. ft. until FY18, (2) construction of additional floors in some stores in tier-2/tier-3, providing more variety to consumers, (3) product-specific exhibitions/melas (chain mela, bangle mela) since October 2017, and (4) increasing traction for its gold deposits scheme due to the government proposal to ban unregulated deposits.

Store expansion to start after a hiatus: TJL hardly added any stores in the past five years due to regulatory headwinds. With these receding, and the government favouring organised players, management plans to add 4,000 sq. ft. annually (i.e., one store a quarter) over the next two years, with a majority of the additions planned in tier-3 and 4 cities within Tamil Nadu, where competition is lower from other organised players.

Margins set to rise: We expect TJL's gross margin to expand to c.10% in FY20 from 8% in FY17 based on: (1) increased share of in-house manufacturing, (2) GST-led savings, (3) higher making charges, and (4) focus on high-margin silver articles and diamond-studded jewellery. Similarly, we expect EBITDA margin to improve to 5.2% in FY20 from 3.7% in FY17 due to benefits of operating leverage and superior gross-margin profile. TJL is likely to see 46% PAT CAGR over FY17-20 as interest costs remain almost flat due to increasing contribution of low-cost gold-on-lease.

Balance sheet provides strong support: TJL's balance-sheet suffered severe stress during FY14-15, as bankers forced the management to liquidate un-hedged inventory to mitigate risks related to declining gold prices. After this experience, the management has been increasingly using low-cost gold-on-lease in order to cope with risks relating to volatility in gold prices and hence, its balance sheet now provides enough support to add stores (with most of the investment going towards inventory).

The golden era is about to begin; initiate coverage with a BUY rating and target of Rs 635: We believe TJL is in a sweet spot as its initiatives of improving SSS growth and network expansion, along with industry tailwinds (read our latest Ground View report titled The dazzling shift to formalisation) provide enough headroom for growth. Reasonable valuations (16x FY20 EPS) offer enough margin of safety to long-term investors. TJL is poised to deliver 46% earnings CAGR over FY17-20 with a sharp improvement in ROIC to c15% from 11% in FY17. We initiate coverage with a BUY rating and target of Rs 635 (20x FY20 EPS).

BUY

CMP RS 509

TARGET RS 635 (25%)

COMPANY DATA

O/S SHARES (MN) :	14
MARKET CAP (RSBN) :	6.8
MARKET CAP (USDMN) :	100
52 - WK HI/LO (RS) :	701 / 221
LIQUIDITY 3M (USDMN) :	0.1
PAR VALUE (RS) :	10

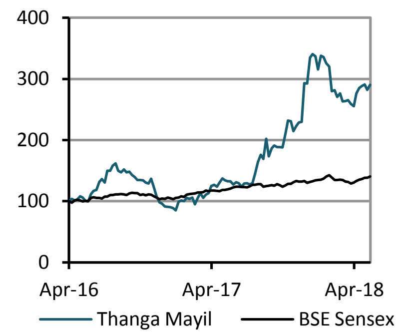
SHARE HOLDING PATTERN, %

	Mar 18	Dec 17	Sep 17
PROMOTERS :	66.4	66.4	70.4
FII / NRI :	0.9	0.8	0.0
FI / MF :	6.0	6.0	6.9
NON PRO :	14.2	14.3	12.1
PUBLIC & OTHERS :	12.5	12.5	10.6

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-10.6	-5.5	116.6
REL TO BSE	-9.8	-6.1	103.3

PRICE VS. SENSEX



Source: Phillip Capital India Research

KEY FINANCIALS

Rs mn	FY18	FY19E	FY20E
Net Sales	13,793	16,436	19,664
EBITDA	594	774	1,022
Net Profit	229	307	436
EPS, Rs	16.7	22.4	31.8
PER, x	30.4	22.8	16.0
EV/EBITDA, x	14.7	11.0	8.5
P/BV, x	4.1	3.6	3.1
ROE, %	13.6	15.9	19.0
Debt/Equity (%)	121.2	139.5	142.0

Source: PhillipCapital India Research Est.

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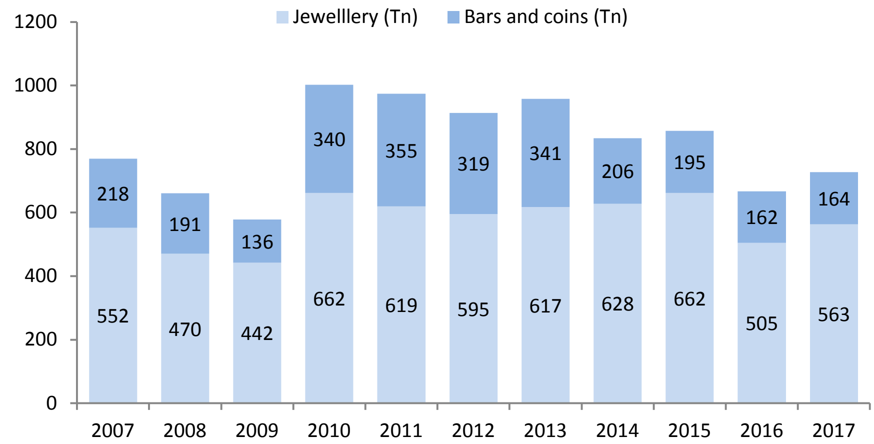
Industry overview

India consumes c.700-800 tonnes of gold annually, and it is believed that Indian households cumulatively hold c.23-24,000 tonnes of gold – this despite gold price remaining subdued in the past few years and the jewellery industry facing many regulatory and structural challenges (please read our latest Ground View report: The dazzling shift to formalisation). Gold jewellery has not meaningfully lost its lustre and India's demand for gold remains insatiable.

India's jewellery demand has held course despite regulatory restrictions imposed by the government



Source: WGC report

Gold jewellery is deeply intertwined in the life of every Indian – it is given to a bride on her wedding (in the form of *stree dhan*), it is given on festivals, and special occasions.

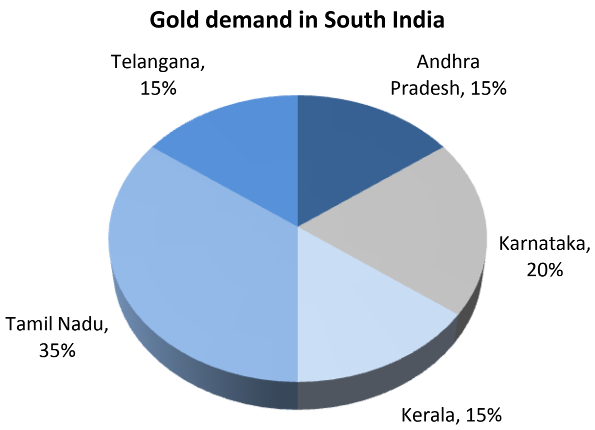
Wedding jewellery occupies a lion's share of the overall demand in India

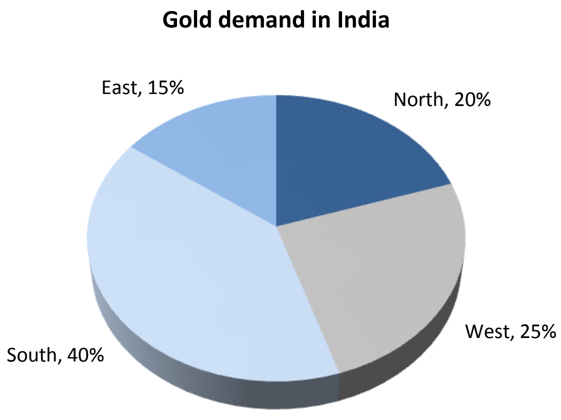
Source: WGC report

Although demand for gold remains broad-based across India, south India has the highest share and constitutes 40% of total gold demand. People in the south are relatively more conservative (lower risk appetite) and prefer gold jewellery/real estate over other investments. Moreover, down south, devotees give lot of gold jewellery to temples as offerings to deities.

Within south India, Tamil Nadu holds the highest share of the gold jewellery market due to economic prosperity and a larger area vs. other states. TN is the second largest state economy in India and the largest in south India with a GDP of US$ 247bn led by services at c.45%, manufacturing at c.34%, and agriculture at c.21%.

Gold demand in India and break up of gold demand in south India





Source: WGC report, PhillipCapital India Research estimates based on GDP of respective state

About Thangamayil Jewellery Ltd (TJL)

Background and scope of operations

- One of the leading south-based jewellery manufacturers and retailers.
- Was called Balu Jewellery earlier. Began operations in 1984 as a manufacturer and trader of jewellery and later ventured into jewellery retailing in 2001 by setting up its flagship showroom at Madurai (11,416 sq. ft.).
- TJL is a family run organisation, with each of co-promoters handling specific responsibility. The second generation has been already inducted, with each of the members given charge of an independent function.
- 32 stores spread across Tamil Nadu. Most of its stores (c.70% of total sq. ft.) are in tier-2 and 3 cities, where competition from other big south-based jewellers is lower.

Operations and revenue

- Revenue mainly comes from plain gold jewellery (c.95%) – because its customers prefer value products. The preference of its customers is different from the customers of listed peers in metro cities or tier-1 cities who have a marked penchant for studded jewellery.
- It currently manufactures 40% of its requirements and its factories are in Madurai and Coimbatore.

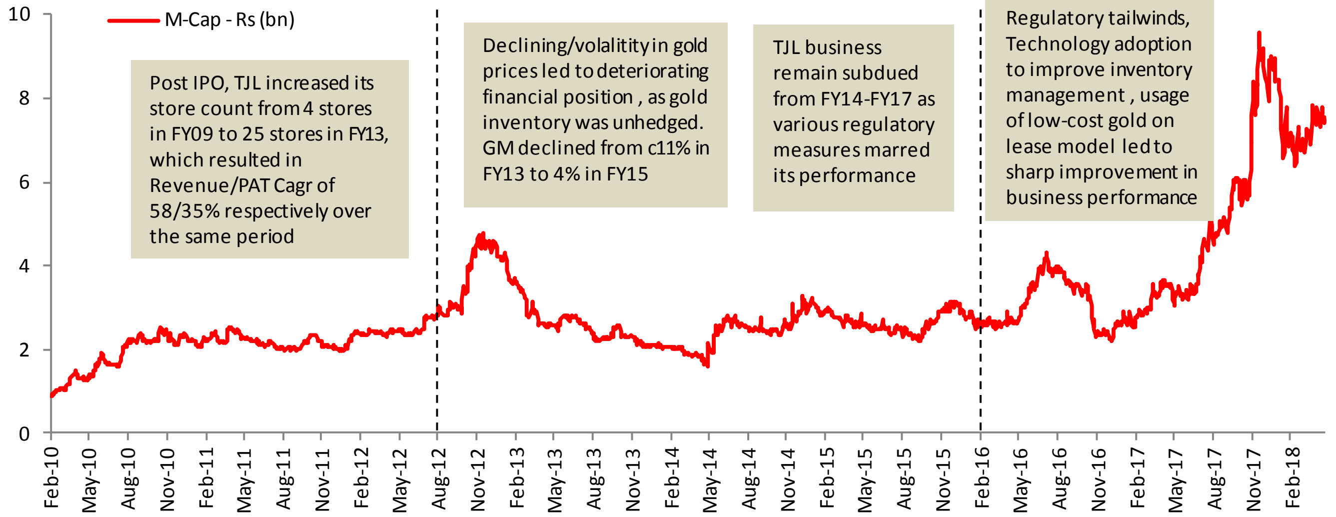
Despite being a family-managed enterprise, TJL believes that it is ‘fairly organised’ as far as store operations are concerned. It follows a similar structure to other jewellery retailers, which is – (1) the store manager handles store executives, and (2) each individual store executive is incentivised to push sales of jewellery.

Management profile

Name	Designation	Age	Qualification	Details
Mr. Balarama Govinda Das	Co-founder and MD	60	B.Com	• Has been the MD since inception • 30 years of experience in manufacturing and trading jewellery • Eldest among three siblings — the other two are B A Ramesh and NB Kumar
Mr. B A Ramesh	Co-founder and Jt. MD	54	H.Sc	• Involved in the family business since he was 18 years old • Played key role in nurturing and modernising the business
Mr. N B Kumar	Co-founder and Jt. MD	50	H.Sc	• Manages the everyday affairs of the company • Specific focus on HR and marketing
Mr. B Rajesh Kanna	CFO	37	Diploma in Gemology	• With the company since 2006; eldest son of Mr Balarama Govinda Das
Mr. B Prasannan	General Manger - HRA	33	Diploma in Gemology and Diamond Grading	• With company since 2007 • Looking after HR • Youngest son of Mr Balarama Govinda Das
Mr. S K Yadeenthranathan	Chief Information Officer		ME. Computer Science	• With the company since 2011 • 15 years experience in IT • Responsible for analytics and digital marketing
Mr. R Gokul	General Manger - Finance		BBM, M.sc in Finance & Risk Management	• With the company since 2014
Mr. N B Arun	General Manger - Sales		B.Com; CS and MBA - HR	• With the company since 2014

Source: Company

Journey of TJL after its IPO in 2010



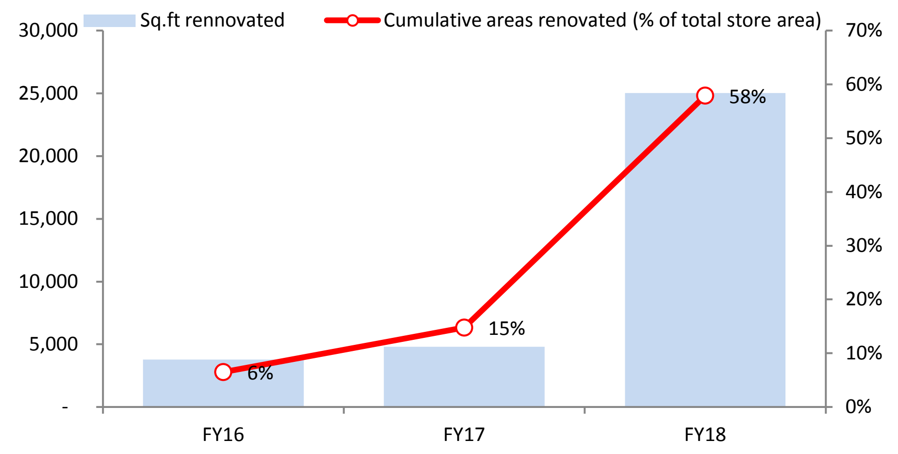
Source: Bloomberg, PhillipCapital India Research

What will drive SSS growth in the medium term?

Store refurbishment improves brand perception
SSS (same-store sales) has remained subdued over the past few years due to weak gold prices and various regulatory measures initiated by the government. To revive SSS, TJL has resorted to store refurbishment. The management has highlighted that this sets the stage for SSS improvement because well-furnished stores enable it to attract new customers and allow it to increase making charges to an extent. Moreover, this refurbishment is being done at minimal capex (Rs 2-3,000 per sq. ft.) and without disturbing its existing business (since most of the work is being done in the night).

TJL has refurbished c.60% (c.33,600 sq. ft.) of store space till the end of FY18, with majority of the work (c.25,000 sq. ft.) in 2HFY18, because of which we expect volume-led SSS growth of 15%/12% in FY19/FY20.

Percentage of cumulative stores renovated



Source: Company

Floor addition in existing stores to aid in improving both range and collection
TJL has constructed additional floors in some of its existing stores in tier-2 and semi-urban areas. The capex for construction of the additional floors is being borne by the respective landlords, while incremental rent is borne by TJL. We believe benefits of higher inventory from the addition of new floors far outweigh benefit of incremental rent(which is a relatively small amount) for TJL since customers are always looking out for more designs/variety. With additional floors, TJL has been able to almost double its inventory, thereby bringing in new customers.

Source: Company

Exhibition/melas allow it to outshine competition, pull in new customers

TJL has started conducting jewellery exhibitions/melas (product-specific melas such as chain mela, bangle mela) since October 2017, mostly targeted at stores in tier-2 cities. In the exhibition period, TJL keeps specific inventory (for examples bangles for a bangle mela) that is equivalent to the entire inventory in that store. TJL runs such exhibitions in a particular area/city for 15 days at a time, and takes whatever inventory remains unsold to the next city in which it holds a similar mela.

With the share of unorganised players being much higher in tier-2 cities, TJL is able to outshine these smaller players, since they cannot compete with its design/variety. The melas help to bring in new customers who might otherwise not have has visited Thangamayil stores.

Chain Exibition (mela) in one of the TJL store

Source: Company

The Unregulated Deposit Bill will boost business from gold-deposit scheme

TJL derived 15-20% of its revenue from its gold-deposit scheme in FY18 (as a comparison, Tanishq derived about 17% in FY18). The management is targeting higher contribution from such schemes over FY19-20, as the unregulated Deposits Bill is passed – which will prohibit jewellers from accepting deposits that are not compliant with the rules and regulations of the gold-deposit scheme (effectively making it difficult for some of the regional/unorganised players). Moreover, customers tend to up-spend by 60% (vs. total amount deposited in the gold deposit scheme) – when they redeem their schemes.

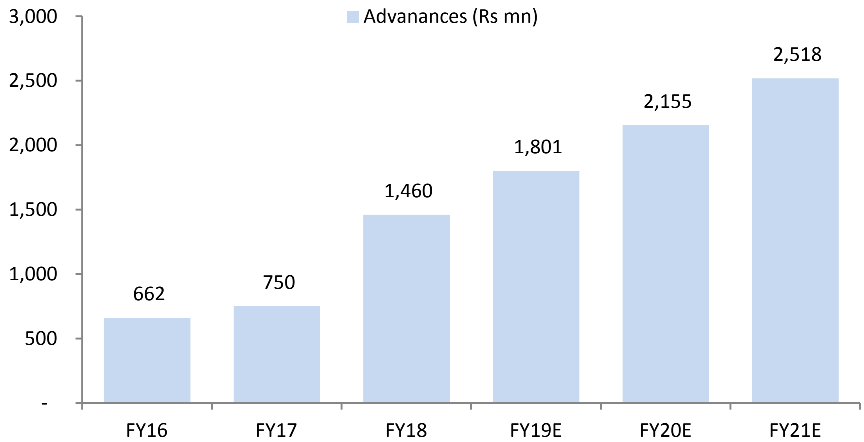
What is a gold-deposit scheme?

Under a gold-deposit scheme, customers pay 11 monthly instalments (for example Rs 1,000 per instalment) and the 12th instalment is generally contributed by the jewellery company. At the end of 11th month, customers are allowed to buy jewellery worth Rs 12,000 from the stock kept at the store.

Restrictions under Companies Act w.r.t these types of schemes:

- Effective return on deposits cannot be more than 12%
- Term of the deposit cannot exceed 12 months
- Under the amended Deposit Regulations Act, the jewellery company can take deposits upto 35% of its networth, and no more than 10% of its networth can be taken from members of the company.

Increasing traction from gold deposit scheme



Source: Company, PhillipCapital India Research Estimates

Structure of Thangamayil gold-deposit scheme is different from Tanishq's

Tanishq	Thangamayil Jewellery
Customer pays 11 monthly instalments and Tanishq contributes 55%/65%/75% of the 12th instalment if the customer redeems the deposit after 300/330/365 days	Customer pays 11 instalments and TJL waives off making charges on jewellery purchases; thus, customers pay for only the gold
This deposit scheme is not available on gold coins and bars	Available on gold coins and bars. However, customers choosing these items will lose because making charges for gold coins and bars are extremely low

Source: Company, PhillipCapital India Research

Shift from unorganised to organised

We believe the following macro factors will benefit all organised jewellers in FY19:

1) The market shifting to the organised sector from unorganised
2) Higher wedding days
3) Forecast of normal monsoon and higher spending before general elections

Tamil Nadu alone contributes 30-35% of South India's gold demand

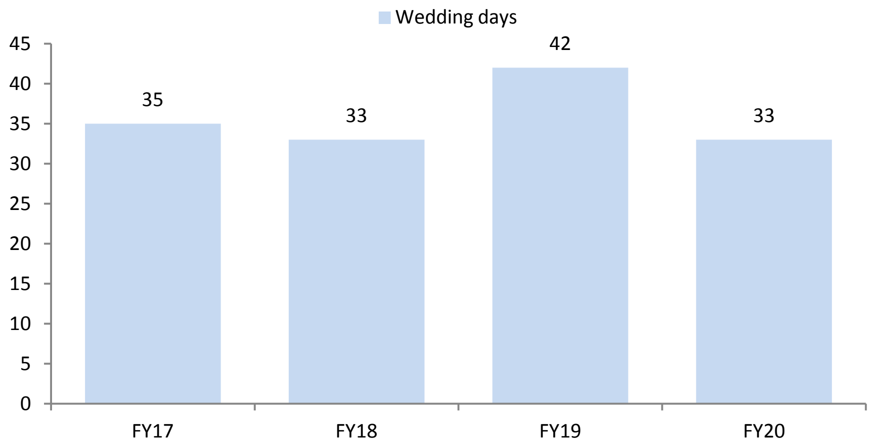
South India constitutes 40% of India's overall gold demand, with the organised sector occupying a significant share (unlike the rest of India). However, in tier-2 and 3 cities in the south, where most of the TJL's stores are located, the share of organised players is relatively lower – expanding TJL's market scope.

We remain extremely bullish on the formalisation theme. Unorganised jewellers are already facing issues due to demonetisation, GST, and hallmarking (which is likely to be implemented soon). This has led to customers switching allegiance to organised jewellers, who offer the advantages of contemporary design, lightweight jewellery, and most importantly, trust. Moreover, unorganised players are facing problems such as their money-lending businesses (significant contributor to profitability) being under pressure, non-availability of gold-on-lease, and limited capital availability, which restricts their ability to invest into their businesses for growth. Their next generations' flagging interest in running the show and increasing family feuds are also major drawbacks.

Higher wedding days in FY19 to boost wedding jewellery

Customers in India, especially south India, keep purchasing gold coins/bars at regular intervals and convert them into jewellery when their children get married. We believe wedding-related jewellery sales will be substantially higher in FY19 due to: (1) a longer wedding season vs. FY18 and, (2) TJL increasing its entire design/range (on back of floor addition in some stores and direct procurement of jewellery from other states)

Higher number of 'wedding days' (considered auspicious) in FY19



Source: Prokerala, PhillipCapital India Research Estimates

Monsoon and higher spending ahead of general elections will drive growth

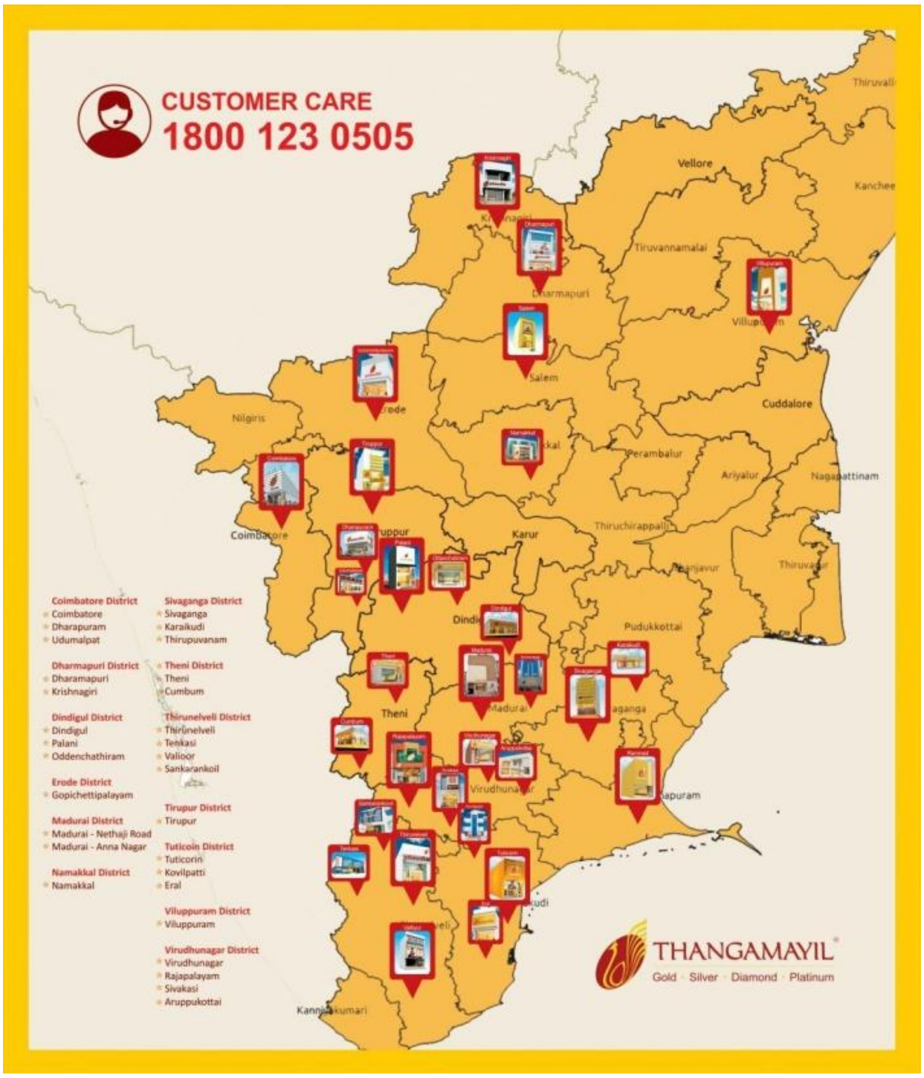
We believe that the forecasts of normal monsoons, higher spending ahead of general elections (scheduled to be held in April-May 2019), and the government's mandate of doubling agricultural income by 2022 – all bode well for TJL because most of its stores are in rural and semi-urban areas, making its customers' incomes tied-in to the agri-economy.

Store expansion after a long hiatus

Stores expansion in tier-2 cities, where organised competition is lower

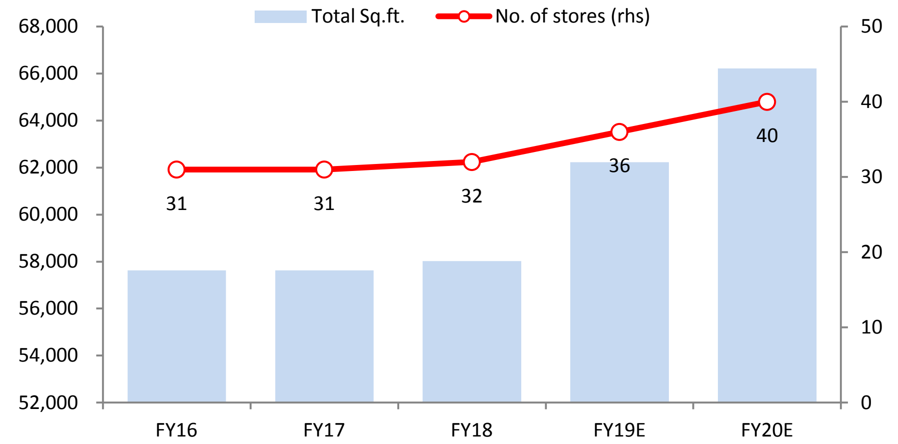
Currently, TJL has 32 stores mostly in the west and south of Tamil Nadu and has hardly added any new stores in the past five years because of regulatory issues and debt burden. Much of its gold was largely unhedged, which led to severe inventory losses as gold prices fell sharply over FY14-15. However, with regulatory headwinds receding, and debt burden easing, the management plans to add four new stores in FY19 – with majority of the additions planned in tier 2 and 3 cities in Tamil Nadu, where competition from organised players is lower.

TJL stores are concentrated in western and southern Tamil Nadu



Source: Company

TJL has hardly added any stores in the past five years



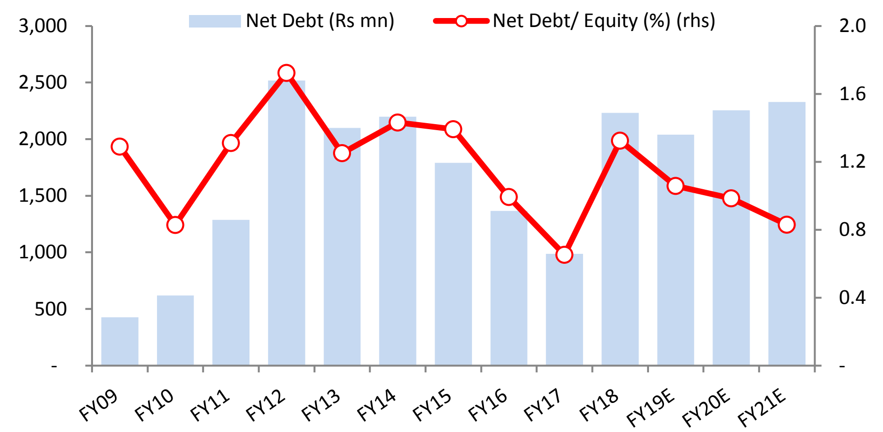
Source: Company, PhillipCapital India Research Estimates

Do not plan to opt for the franchisee route in the short term: TJL does not plan to add stores via the franchisee route vs. other organised players who are incrementally planning to add stores via the franchisee store. The management says that the current capital structure provides sufficient strength for adding stores on its own and at its scale; it will not be in a position to offer the kind of trade terms to franchisee partners that its competitors offer.

Is TJL in a position to fund expansion?

TJL will add 4-5 stores every year for the next three years. We believe its balance-sheet supports this kind of growth, given that the major investment for setting up any store is towards gold inventory (95%) and it is in a comfortable position to fund this by availing the gold-on-lease facility from banks. On an average, TJL spends around Rs 5,000-6,000 per sq. ft. for setting up a store, which in line with other organised mid-sized jewellers.

Net debt / equity to remain at current levels

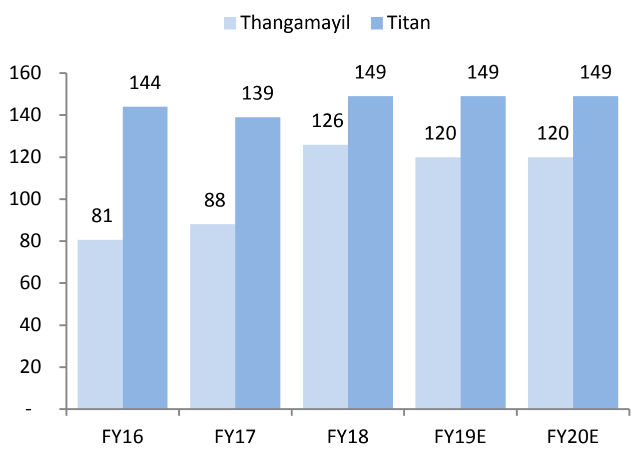


Source: Company, PhillipCapital India Research Estimates

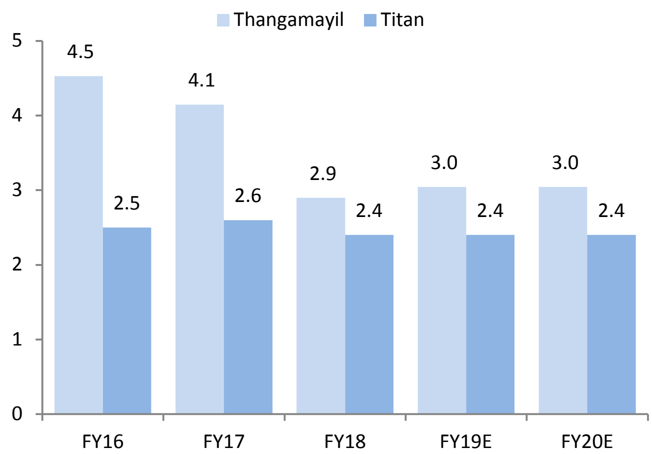
Why TJL's is inventory turnover ratio much better than Tanishq's?

- Inventory turnover ratio for Thangamayil is better than Tanishq's as it mainly sells plain gold jewellery, which is fast moving. In contrast, 30% of Tanishq's jewellery business comes from studded jewellery, where movement is a bit slower, given it is more discretionary and holds a higher ticket value.
- Most of TJL's stores are located within a 50-100 kms radius of one another, making it easier for the company to circulate inventory between two stores.
- Intensity of gold purchases is highest in Tamil Nadu, where TJL is concentrated. Titan is spread across India.

Inventory days



Inventory turnover ratio

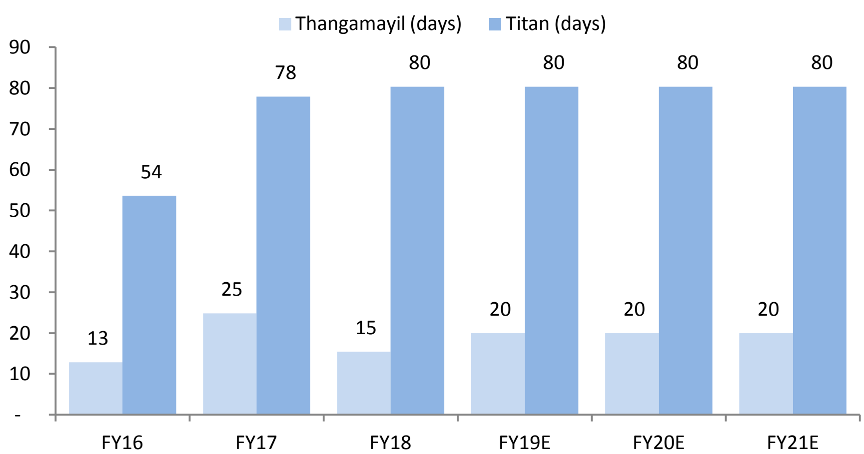


Source: Company, PhillipCapital India Research Estimates

Low creditor days for Thangamayil

Generally, debtors for jewellery companies are minimal. This is because business is largely conducted in cash (over the counter); no credit is given to customers. We cannot easily compare creditors of two jewellery companies because it would depend on how inventory is financed and the accounting treatment of each company. For example, if inventory is financed using gold on lease, then such a company would have more creditors on its books, and if inventory is financed using bank finance, then it will reflect as bank borrowings. Creditor days for Thangamayil are lower because it procures a good amount of its inventory from internal accruals and not thorough bank finance.

Creditor's days



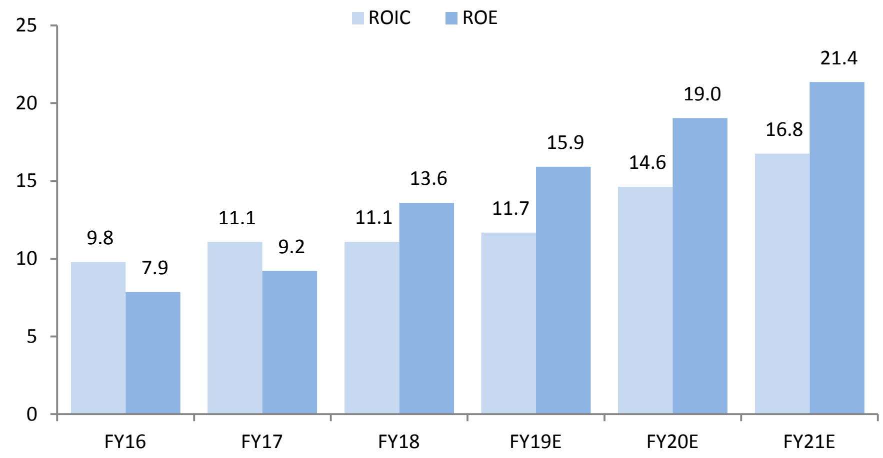
Source: Company, PhillipCapital India Research Estimates

Du-Pont analysis of ROE

Operating metrics	Explanation	FY16	FY17	FY18	FY19	FY20	FY21
PAT margin	PAT/Sales	0.8	1.1	1.7	1.9	2.2	2.6
Sales Turnover ratio	Sales/Total assets	4.5	4.8	3.3	3.2	3.3	3.3
Leverage	Total assets/shareholders funds	2.1	1.8	2.5	2.7	2.6	2.5
	ROE	7.9	9.2	13.6	15.9	19.0	21.4

Source: Company, PhillipCapital India Research Estimates

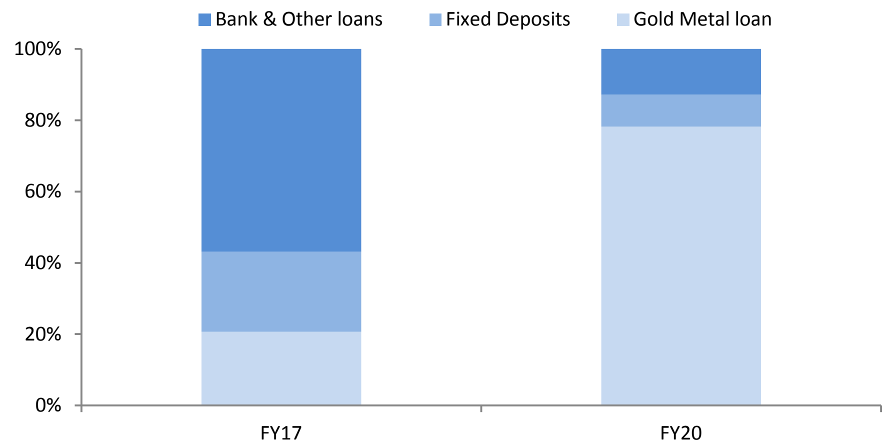
ROE and ROIC - TJL



Source: Company, PhillipCapital India Research Estimates

We expect its ROE to pick up – to 21.4% in FY21 from 9.2% in FY17 – due to an improvement in EBITDA margins on favourable product mix and operating leverage.

Funding mix: FY17 vs. FY20



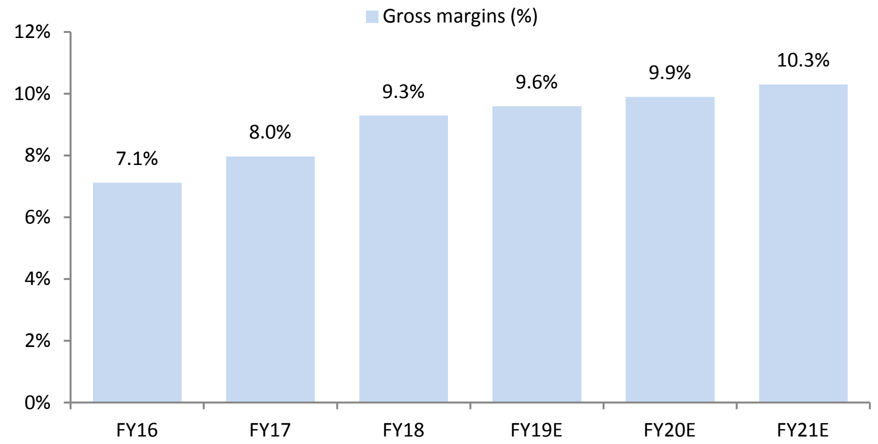
Source: Company, PhillipCapital India Research Estimates

Gross margin is rising

We expect gross margin to improve to c.10% by FY20 from 8% in FY17 due to:

(1) Increased share of in house manufacturing
(2) Increase in making charges
(3) GST enabling a level playing field
(4) The company pushing sales of high-gross-margin silver items thorough TJL 'Smart Stores'
(5) Its focus on the high-margin diamond studded jewellery in tier-1 cities

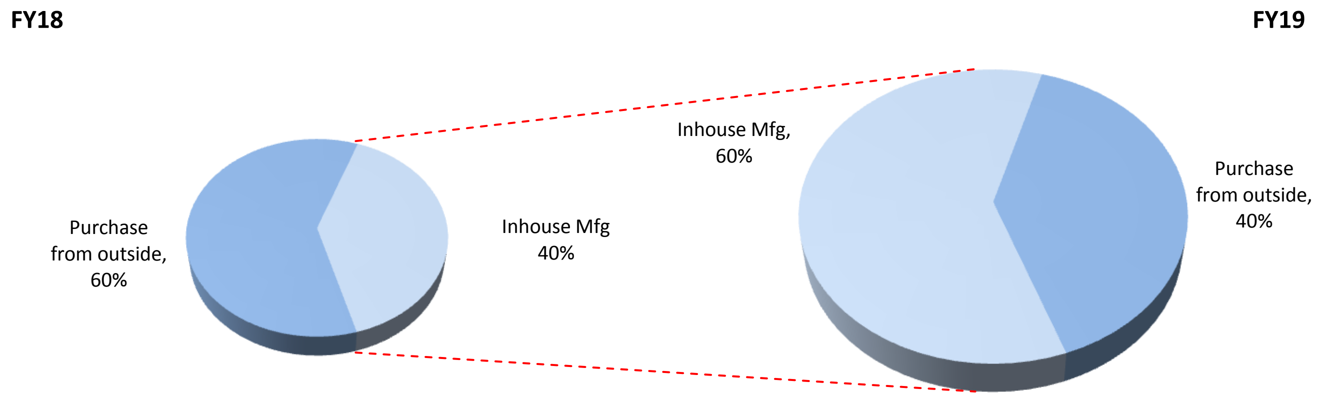
Gross margins to see sharp expansion in the medium term



Source: Company, PhillipCapital India Research Estimates

Increased share of in house manufacturing: TJL plans to increase this share to 60% in FY19 from 40% in FY18, which will boost its gross margins. This type of manufacturing leads to a savings of 2-3% in making charges.

In house manufacturing to increase its share



Source: Company, PhillipCapital India Research Estimates

Intends to increase making charges: Management has said that it had to keep its making charges at the lower end (of organised jewellers), mainly because it had to focus on pushing its inventory faster as it was under pressure from banks for loan repayments. TJL's balance sheet is now healthy, and it believes it will be able to increase its making charges marginally as unorganised jewellers lose their edge of under-karating (with hallmarking being implemented).

GST creates a level playing field: We believe that GST is beneficial for TJL because: (1) it can now procure goods anywhere from India at zero incremental costs (before GST, it had to pay CST, for which no input credit was available, which suppressed its gross margins), and (2) availability of input tax credit on expenses (not available pre-GST) shall boost operating margins.

High-margin silver to receive a further push thorough TJL 'Smart Stores'

The management intends to push high-gross-margin silver items (7% of sales in FY17) thorough its 'TMJL Plus' stores. Silver items have a gross margin of 15-18% (vs. gold jewellery's 7-9%). TJL has set up one TMJL Plus store in FY18, and depending on its success, it plans to add a few more.

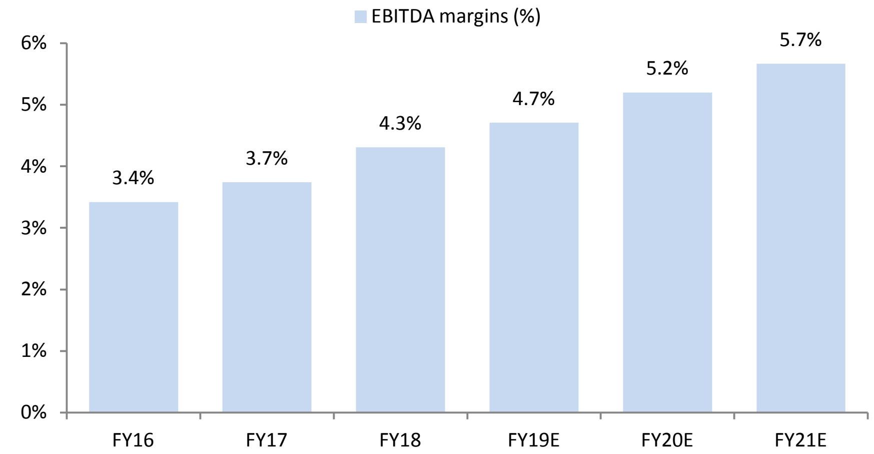
TMJL Plus stores

1) Small-sized stores measuring 100-200 sq. ft.
2) Also serves as a customer-care centre for collecting instalments for the gold-deposit scheme.
3) Plans to sell high-gross-margin silver articles thorough this store

Focusing on margin-accretive diamond studded jewellery in tier-1 cities: TJL plans to increase the contribution of its diamond-studded jewellery (less than 1% of total sales currently) for its stores in tier-1 cities – to 5% of total sales in the medium term. For this, it has created a separate section in such stores and has been training and incentivising its employees to push sales.

EBITDA margin to see massive swing: We expect EBITDA growth of 28% over FY17-20 and EBITDA margin will move to 5.2% in FY20 from 3.7% in FY17 due to: (1) favorable product mix, (2) cost-efficiencies programme, and (3) benefits of operating leverage flowing in.

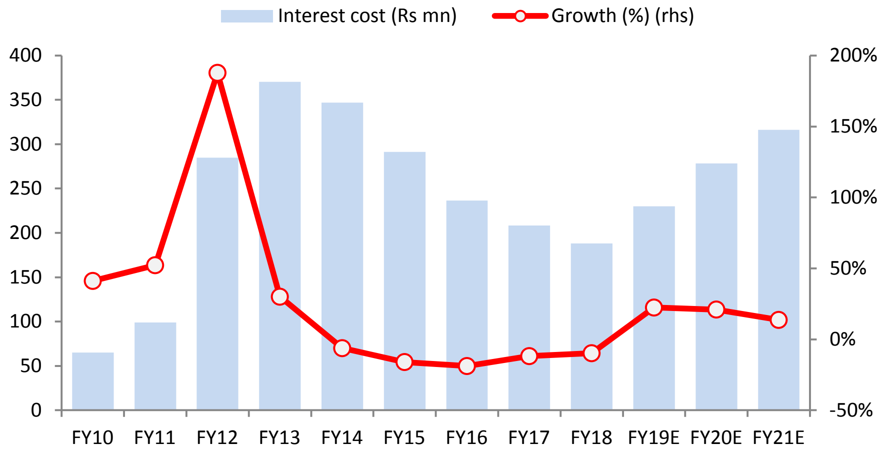
EBITDA margin



Source: Company, PhillipCapital India Research Estimates

PAT to see massive jump: We expect PAT growth of 46% over FY17-20 due to: (1) superior operating performance, and (2) flat interest costs despite massive increase in working capital requirements. Interest costs are likely to remain almost flat as TJL procures incremental inventory under low-cost gold on lease. Currently, it is being procured using high-cost fixed deposits / cash-credit facility and instalments collected under its gold-deposit scheme.

Interest expense



Source: Company, PhillipCapital India Research Estimates

Don't paint everyone with the same brush

Not a great history, but the future is bright: Investors view the Indian jewellery sector with lot of suspicion. This is because historically, Indian jewellery companies have been fraught with malpractices and many times, jewellery businesses were used as a front to park illicit money generated by various vested interests (real estate developers, office-bearers, etc.). We believe that with the government focusing on formalisation (GST implementation, demonetisation and compulsory hallmarking), amendments in PMLA and Benami act, introduction of RERA, the flow of illicit money could reduce significantly, and companies who mean to do genuine business will succeed.

Gold: A deep love: The Indian jewellery sector (US$ 50bn) holds lot of promise as gold is deeply intertwined in Indian people's lives – be it festivals, weddings, or other family functions. Gold demand is particularly strong in south India, which constitutes 40% of total gold demand.

Trial by fire: Organised players have emerged stronger: The Indian jewellery industry was badly impacted over the past few years because the government's regulatory actions (increase in import duty to 10% from less than 1%, threshold for PAN card disclosure reduced, restriction on gold procurement, and regulations on gold-deposits schemes). However, of late, organised players are seeing healthy growth as the government backs its mandate of formalisation with demonetisation, GST, and hallmarking (to be implemented soon). These measures have led to customers switching to organised jewellers, who offer the advantages of contemporary design, lightweight jewellery, and most importantly, trust. Meanwhile, unorganised players are facing problems such as their money-lending businesses (significant contributors to profitability) being under pressure, non-availability of gold-on lease, and limited capital availability, which restricts their ability to invest into their businesses for growth. Their next generations' flagging interest in running the show and increasing family feuds are also major drawbacks.

The not-so-secret reasons for Titan's premium: Titan trades at rich valuations and at a significant premium to the industry average (in PE terms) because of: (1) strong brand equity; it comes from Tata' stable and trust is of paramount importance in high-ticket value item such as jewellery, (2) network effect (pan-India reach) makes it a major beneficiary of a switch from the unorganised sector, and (3) its focus on offering differentiated designs backed by out-of-the-box ad campaigns enables it to gain market share from unorganised players

Difference in valuation between Thangamayil and Titan justified to an extent…. We believe that the valuation difference is justifiable to an extent given that: (1) Titan is a national player while TJL is a state-specific player (exposed to geographical vagaries), (2) Titan is focused on a larger and growing market of differentiated jewellery, which allows it to earn higher margins while Thangamayil focuses on a narrow yet strong 'plain jewellery' market, and (3) the trust that any Tata brand enjoys – which any other jewellery brand will find very tough to match.

…but we are bullish on Thangamayil Jewellery too: We have tried to make comprehensive checks on TJL's promoters, management quality, and corporate governance practices – and have found everything in good order. In fact, in several instances, we actually came away with more positive inputs than we had anticipated (raising the TJL management's quality in our eyes). This is why we believe that it is important not to view all jewellery companies with prejudice. Below are some examples of why we were impressed.

- Promoters surrendered their salary when the company was in crisis: In FY14, the directors surrendered their remuneration of Rs 12.6mn, though legally they were entitled to draw a higher amount of Rs 27mn from the company.
- Halted store expansion when there were regulatory headwinds.

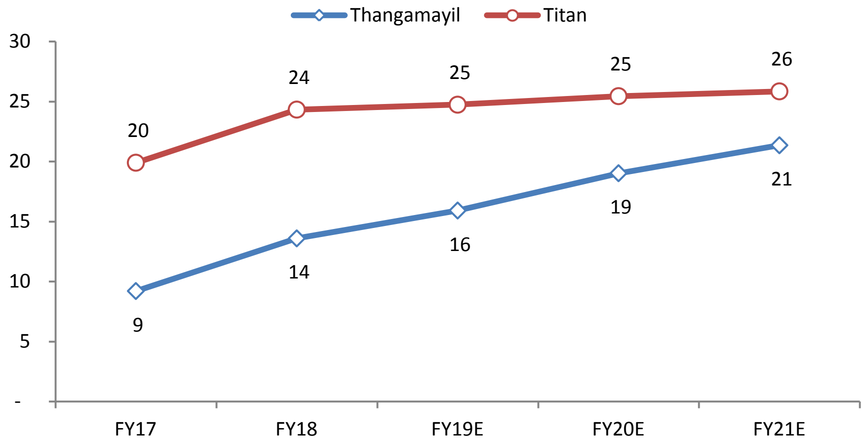
Valuation

We believe TJL is in a sweet spot, as its initiatives of improving SSS growth and network expansion, coupled with industry tailwinds, provides enough headroom for growth. Reasonable valuations (16x FY20 EPS) offer enough margin of safety to long-term investors. We expect EBITDA margin to improve to 5.2% in FY20 from 3.7% in FY17 on favorable product mix, better utilisation of existing space, and its frequent exhibitions/melas. TJL is poised to deliver 46% earnings CAGR over FY17-20 with a sharp improvement in ROIC (to c15% in FY20 from 11% in FY17).

We believe, TJL's substantial discount to Titan is unwarranted as both are expected to post strong performance in the medium term (PAT CAGR of 46% over FY17-20 vs. 33% Cagr for Titan) and their return ratios will converge.

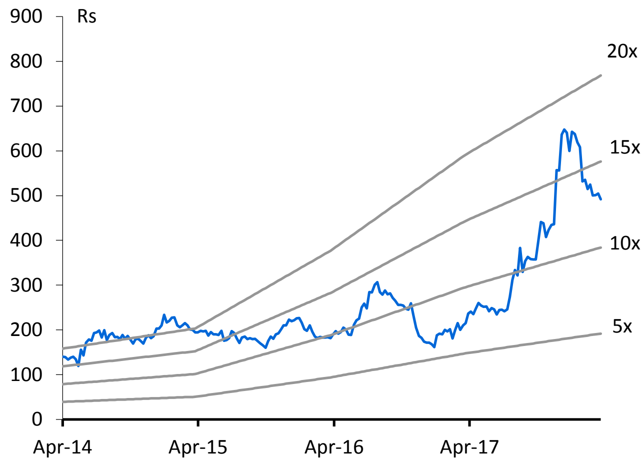
We initiate coverage with a BUY rating and target of Rs 635 (20x FY20 EPS), a substantial discount to the market leader, despite having a similar return profile.

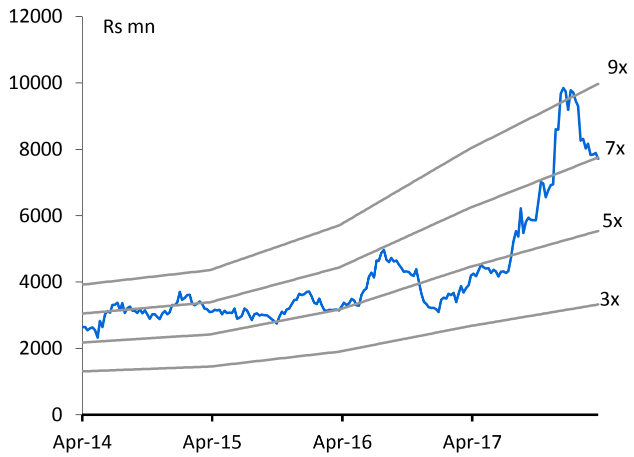
ROE for Thangamayil and Titan



Source: Company, PhillipCapital India Research Estimates

One-year forward P/E band **EV/EBITDA**





Source: Company, PhillipCapital India Research Estimates

Risks

Geographic concentration

We believe geographical concentration poses a downside risk to our estimates as natural calamities (drought, flood) and political instability may derail growth. In our view, a natural calamity can have substantial impact (since majority of the stores are located in semi-urban/rural area) on its financials, but a downfall of the state government is at best likely to impact financials for 1-2 quarters.

Aggressive expansion by competitors

Many south-based jewellers such as Kalyan Jewellers, Malabar Gold, and Joyalukkas are planning to tap the capital markets, which may intensify competition for organised jewellers. We believe the threat for TJL is relatively lower, since most of the stores located in semi-urban/rural areas, which these players may not find viable enough to operate in.

Volatility in gold prices

We believe that sharp volatility in gold prices in the short term may dent financials since a portion of gold jewellery remains un-hedged. However, we believe the management's strategy of using gold on lease for financing incremental inventory and high stock turnover ratio will restrict the impact at best to 1-2 quarters.

Regulatory risks

Jewellery demand was severely hit in August 2017, when the government decided to amend PMLA (Prevention of Money Laundering Act), which required disclosing an identity card for any purchase above Rs 50,000. Demand returned to normal levels in October 2017 after the PMLA Act provisions were revoked. Any government moves to reduce the current disclosure threshold of Rs 200,000 may dampen demand for organised jewellers.

Financials

Income Statement

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Net sales	**13,793**	**16,436**	**19,664**	**22,977**
Growth, %	7	19	20	17
Other income	16	19	29	44
Total income	13,808	16,455	19,693	23,021
Raw material expenses	-12,511	-14,858	-17,717	-20,610
Employee expenses	-320	-384	-441	-507
Other Operating expenses	-368	-421	-483	-557
EBITDA (Core)	**594**	**774**	**1,022**	**1,302**
Growth, %	22.7	30.2	32.1	27.4
Margin, %	4.3	4.7	5.2	5.7
Depreciation	-82	-105	-123	-135
EBIT	**512**	**669**	**899**	**1,167**
Growth, %	31.5	30.5	34.5	29.8
Margin, %	3.7	4.1	4.6	5.1
Interest paid	-188	-230	-278	-316
Other Non-Operating Income	16	19	29	44
Non-recurring Items	0	0	0	0
Pre-tax profit	**340**	**458**	**650**	**895**
Tax provided	-111	-151	-215	-295
Profit after tax	**229**	**307**	**436**	**599**
Others (Minorities, Associates)	0	0	0	0
Net Profit	**229**	**307**	**436**	**599**
Growth, %	64.4	33.8	42.0	37.6
Net Profit (adjusted)	**229**	**307**	**436**	**599**
Unadj. shares (m)	14	14	14	14
Wtd avg shares (m)	14	14	14	14

Balance Sheet

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Cash & bank	319	1,159	1,505	1,821
Debtors	13	13	13	13
Inventory	4,759	5,404	6,465	7,554
Loans & advances	151	180	215	252
Other current assets	338	338	338	338
Total current assets	5,581	7,093	8,536	9,978
Gross fixed assets	1,245	1,381	1,515	1,659
Less: Depreciation	-504	-609	-732	-867
Add: Capital WIP	9	9	9	9
Net fixed assets	750	780	791	801
Total assets	**6,315**	**7,858**	**9,311**	**10,762**
Current liabilities	4,118	5,420	6,512	7,446
Total current liabilities	4,118	5,420	6,512	7,446
Non-current liabilities	510	510	510	510
Total liabilities	4,628	5,930	7,022	7,956
Paid-up capital	137	137	137	137
Reserves & surplus	1,550	1,791	2,152	2,669
Shareholders' equity	1,687	1,928	2,289	2,806
Total equity & liabilities	**6,315**	**7,858**	**9,311**	**10,762**

Source: Company, PhillipCapital India Research Estimates

Cash Flow

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Pre-tax profit	340	458	650	895
Depreciation	82	105	123	135
Chg in working capital	-78	628	-5	-192
Total tax paid	-18	-151	-215	-295
Other operating activities	-500	-560	-780	-360
Cash flow from operating activities	**-174**	**480**	**-226**	**183**
Capital expenditure	-101	-135	-134	-144
Cash flow from investing activities	**-101**	**-135**	**-134**	**-144**
Free cash flow	-276	345	-360	39
Equity raised/(repaid)	172	241	362	517
Debt raised/(repaid)	-50	0	0	0
Dividend (incl. tax)	-58	-66	-74	-82
Other financing activities	291	245	385	-189
Cash flow from financing activities	**355**	**420**	**672**	**246**
Net chg in cash	80	765	312	285

Valuation Ratios

Y/E Mar, Rs mn	FY18	FY19E	FY20E	FY21E
Per Share data				
EPS (INR)	16.7	22.4	31.8	43.7
Growth, %	64.4	33.8	42.0	37.6
Book NAV/share (INR)	122.9	140.5	166.9	204.5
FDEPS (INR)	16.7	22.4	31.8	43.7
CEPS (INR)	22.7	30.0	40.7	53.5
CFPS (INR)	(83.5)	27.4	(2.7)	8.0
DPS (INR)	3.5	4.0	4.5	5.0
Return ratios				
Return on assets (%)	7.8	7.6	8.3	9.1
Return on equity (%)	13.6	15.9	19.0	21.4
Return on capital employed (%)	20.5	23.1	27.2	29.9
Turnover ratios				
Asset turnover (x)	5.2	4.8	5.2	5.3
Sales/Total assets (x)	2.6	2.3	2.3	2.3
Sales/Net FA (x)	18.6	21.5	25.0	28.9
Receivable days	0.3	0.3	0.2	0.2
Inventory days	125.9	120.0	120.0	120.0
Payable days	16.2	21.0	21.1	21.2
Working capital days	30.2	11.4	9.6	11.3
Liquidity ratios				
Current ratio (x)	1.4	1.3	1.3	1.3
Quick ratio (x)	0.2	0.3	0.3	0.3
Interest cover (x)	2.7	2.9	3.2	3.7
Total debt/Equity (%)	121.2	139.5	142.0	129.7
Net debt/Equity (%)	102.2	79.4	76.2	64.8
Valuation				
PER (x)	30.4	22.8	16.0	11.7
PEG (x) - y-o-y growth	0.5	0.7	0.4	0.3
Price/Book (x)	4.1	3.6	3.1	2.5
EV/Net sales (x)	0.6	0.5	0.4	0.4
EV/EBITDA (x)	14.7	11.0	8.5	6.8
EV/EBIT (x)	17.0	12.7	9.7	7.5

Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

Rating	Criteria	Definition
BUY	>= +15%	Target price is equal to or more than 15% of current market price
NEUTRAL	-15% > to < +15%	Target price is less than +15% but more than -15%
SELL	<= -15%	Target price is less than or equal to -15%.

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