

Indian Gems & Jewellery

Every record should be considered in light of the other outcomes that could have occurred just as easily as the 'visible histories' that did.

- Nassim Nicholas Taleb,
Fooled by Randomness

In the (Gold)ilocks zone

What's VISIBLE to investors?

- Durable growth, anchored to wedding demand
- A huge trust deficit in unorganised retail POS
- Pro-organised regulatory push, incl. demonet + GST
- Tightening credit lines for jewellers

What's LESS visible?

We visited players across the Indian jewellery value chain in six cities to validate the 'visible' and to discover some of the 'not so visible' moving parts. Our findings:

1. India's jewellery story is mostly about the SUPERPACK (**17 organized jewellery chains that will grab ~42% share in the next five years**). The SUPERPACK has significant diversity – in current operations as well as growth strategies.
2. Battle for market share will be played in **North and West India**, away from the largest market (South). Only one SUPERPACK player is choosing to opt out.
3. Our India visit suggests jewellery may have some legs (~6% CAGR built over FY18-23E). However, as a category, jewellery could so easily have an 'alternative history' - may **not** grow apace with demographic (and income) tailwinds, despite the 'anchor' wedding segment, and may even slip down the discretionary spending ladder. **For us, this is the biggest 'invisible' that investors must recognise.**
4. **Street folly:** RoCEs are overstated in proforma accounts. We prefer to see gold on lease and Gold schemes as debt!

Titan looks like the big winner right now, but 'DEFENCE' will be the operating word as SUPERPACK closes in. Business gains are priced in. Initiate coverage with NEUTRAL. Thangamayil is evolving in tandem with

regulatory tailwinds. It is poised to drive up return ratios significantly over the next few years, flowering in its core markets. **Initiate coverage with BUY.**

What's inside?

- **SUPERPACK to corner 42% of the market by FY23:** India's jewellery market has actually remained flat at Rs 2.7tn over FY14-18 as both volume and price have remained stable. However, the SUPERPACK is estimated to have grown at ~11% CAGR, implying a clear shift of business towards the organized trade as the latter aggressively expanded its footprint by an estimated 2mn sq feet. We expect the SUPERPACK to corner ~42% of the domestic market by FY23E (vs ~29% currently) underpinned by their aggressive expansion drive, design might and increasingly competitive pricing vis-à-vis family jewellers.
- **Design to separate the men from the boys:** Market share battle will be fought with the breadth/depth of designs as pricing premium, gold scheme offerings, repurchase/exchange commission across the SUPERPACK are converging. **~3/4 of the combined top-line of key South jewellers comes from the 5 southern states**, where customer purchasing behavior is largely homogenous in terms of designs. 67-100% of their stores are South-based too, implying weaker artisans tie-ups in rest of India. Our interactions with management of major south jewellers suggested that they are proactively fixing this gap and increasing their non-south 'Karigar' pool. Hence, the design arbitrage will dwindle in the medium-term. **Based on our store visits, we reckon jewellers like Joyalukkas, Kalyan Jewellers and PCJ may be closer to catching up with Titan on the design curve vis-à-vis others.**

Company	Reco	TP
Titan	NEU	820
Thangamayil	BUY	650

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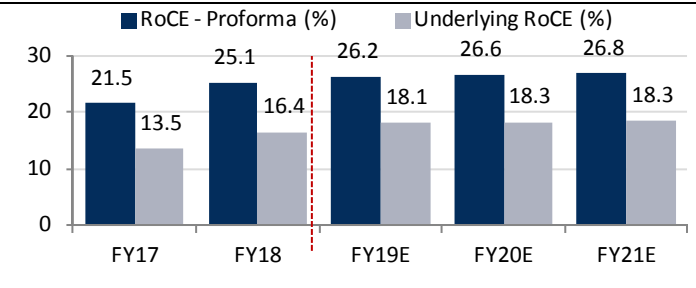
- **North and West - the bone of contention:** The SUPERPACK accounts for a measly 4% of the BIS-listed jewellery stores in North and West (vs ~8% store share/~40% revenue share down South). Scope for penetration, coupled with higher profitability from impulse purchases and studded jewellery off-take, make North and West the bone of contention. Key south jewellers concur that north and west is where the battle will be fought. While Titan remains a distant leader in terms of national presence, able contenders are visible across all zones. These include PC Jeweller (North), Kalyan Jewellers, Malabar Gold, Joyalukkas (South) and Senco (East). GRT (one of the biggest, leanest and most efficiently managed organized jewellers in India) believes there is enough scope down South and will remain there for the next 2-3 years.
- **Different strokes for different folks:** Most South-based players prefer the owned store route vs. the franchisee route for expansion (barring Malabar). While this decision may be inconsequential, as major investments are towards inventory (93-95%), the unencumbered cash levels and leverage position of select big-box jewellers warrant a capital infusion for geographical expansion. However, this advantage for Titan can dwindle over the next couple of years as select jewellers are either expected to hit capital markets or are tying up more debt over FY18-20E.
- **Exchange schemes – SSSG booster:** The up-selling opportunity presented by an attractive gold exchange scheme can help the SUPERPACK grow SSSG. ~50-70% of their customer base are repeat customers who are ideal candidates for exchange schemes. **Titan and PCJ account for ~5% & ~2% respectively of the total gold exchange market.** Across zones, big-box jewellers have revised their exchange programme (more lucrative for consumers now) to capture the up-selling opportunity.
- **Titan wins, but peers closing in.** Given the current design/capital arbitrage, we believe Titan will have a head-start on the customer acquisition race over FY18-21E. Co is confident on achieving its aspired 25% jewellery revenue growth in FY19E. However, peer gaps will reduce post FY21 (Phase 2 of our medium term view) and Titan will find itself defending turf against very strong and able challengers across India. This may impact Titan's long-term growth and profitability.
- **Stocks :**
 - **Titan remains the best business, albeit it's no See's Candy** given the industry's 'put-up-more-to-earn-more' business model. The 2-3 year head-start on designs and capital provides healthy growth visibility. Expect revenue/EBITDA/PAT CAGR of 20/25/23% over FY18-21E and improvement in ROICs by ~200bps to ~20% (in our restated format).

Despite baking in all plausible tailwinds in Phase 1, current valuations keep us at bay. We have a NEUTRAL recommendation with a DCF-based TP of Rs 820/sh (implying 42x FY19 EPS). Our FY19/FY20 EPS estimates are 5/9% below consensus.
 - **Thangamayil is a classic turnaround story** with multiple levers to pull. We expect Thangamayil to deliver a revenue/EBITDA/PAT CAGR of 18/24/31% and economic spread (RoIC-WACC) to improve by ~490bps to 4% by FY21. Recommend a BUY with a DCF-based TP of Rs 650/sh.
- **Wait, there's more** (1) Key takes from management interactions at SUPERPACK, store visits across India, (2) Key districts across India which could potentially be (gold)mines for customer acquisition.

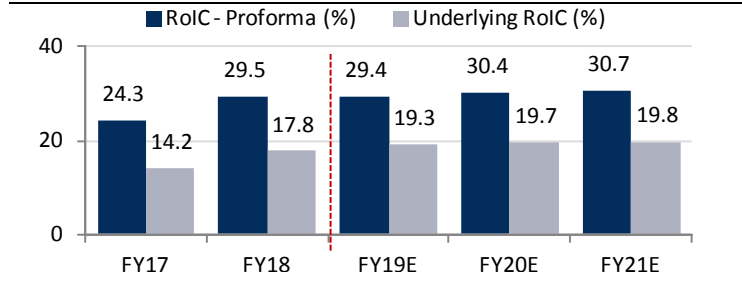
Meanwhile, some Street folly...

Key listed jewellers classify (1) Gold procured on lease from banks as Trade Payables, and (2) 'Deposits outstanding as a part of schemes' under Current Liabilities. As both liabilities are interest bearing, we reclassify them as DEBT, which knocks up capital employed significantly. Titan has recently started classifying gold loans separately, but the Street continues to exclude them from debt. As a result, jewelers report optically high return ratios. On the other hand, our method depicts a more genuine picture of the underlying returns profile of the business.

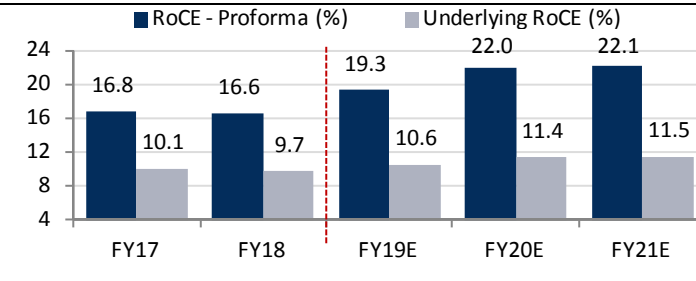
Titan: Proforma vs underlying RoCE



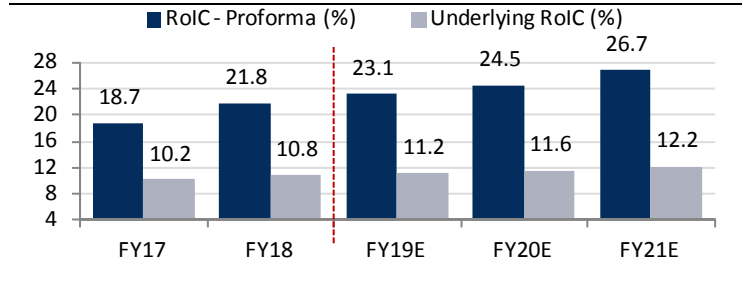
Titan: ROIC – Proforma vs underlying ROIC



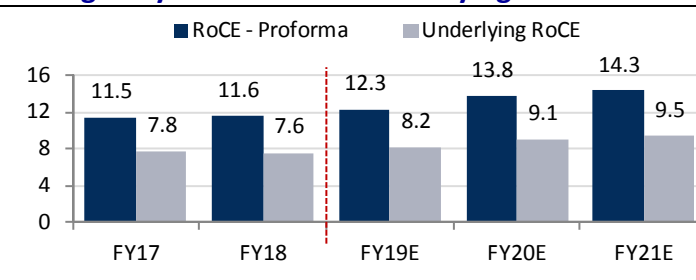
PCJ: Proforma vs underlying RoCE



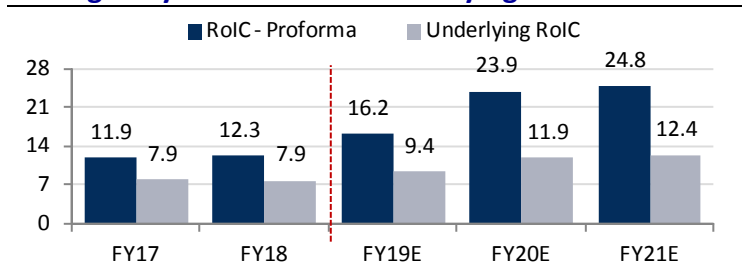
PCJ: Proforma vs underlying ROIC



Thangamayil: Proforma vs underlying RoCE



Thangamayil: Proforma vs underlying ROIC



Source: Company, HDFC sec Inst Research

Source: Company, HDFC sec Inst Research

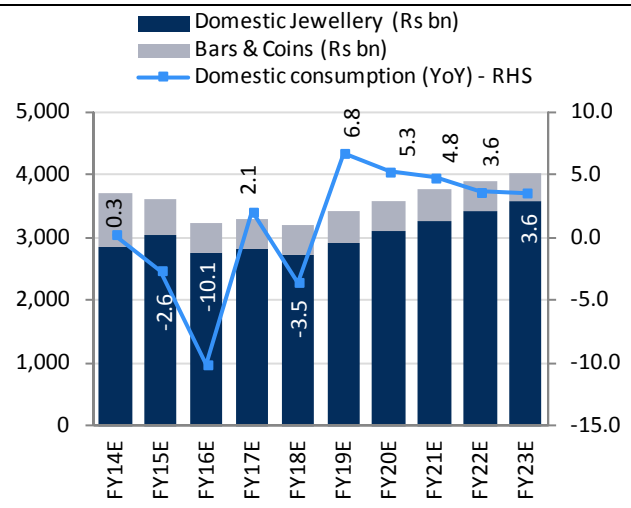
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Story in charts

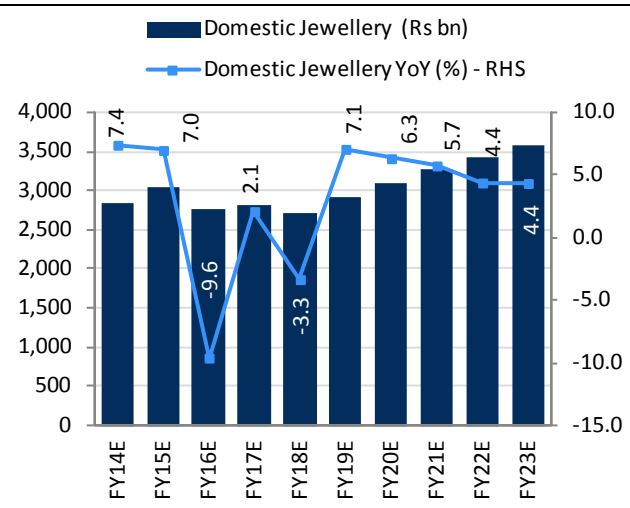
Indian Bride to keep jewellery demand stable; SUPERPACK accounts for a quarter in weddings

India Consumption Market: ~5% CAGR over FY18-23E



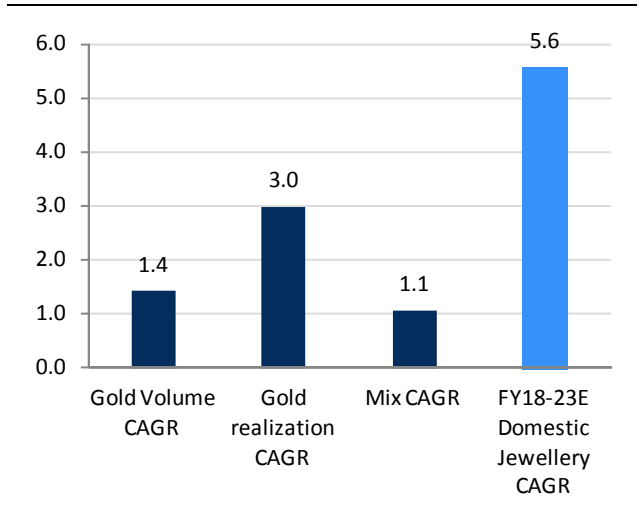
Source: HDFC sec Inst Research

....jewellery to grow at ~6% CAGR



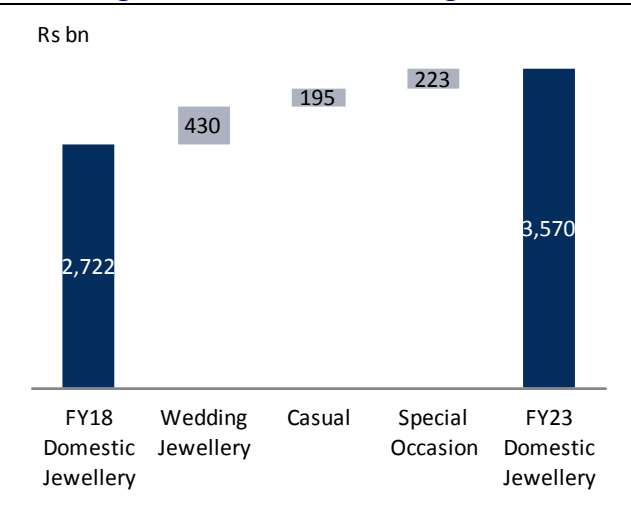
Source: HDFC sec Inst Research

India Jewellery: Growth drivers over FY18-23



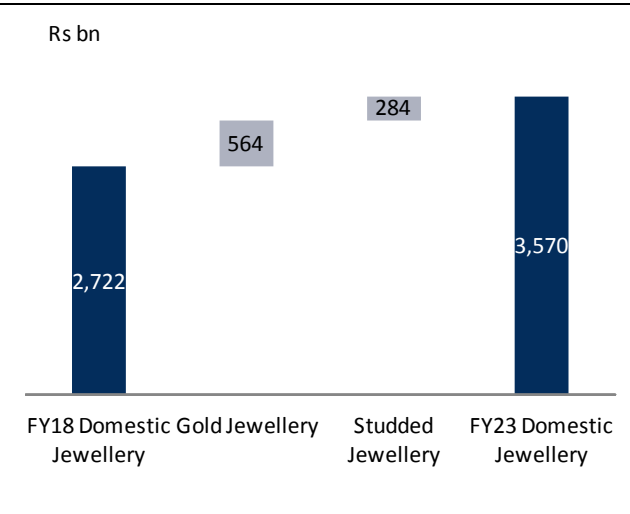
Source: HDFC sec Inst Research

Weddings to contribute half the growth



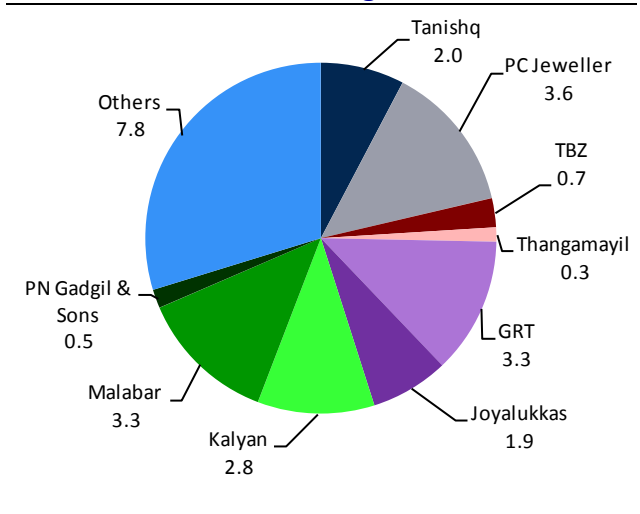
Source: HDFC sec Inst Research

Gold/Studded contribution



Source: HDFC sec Inst Research

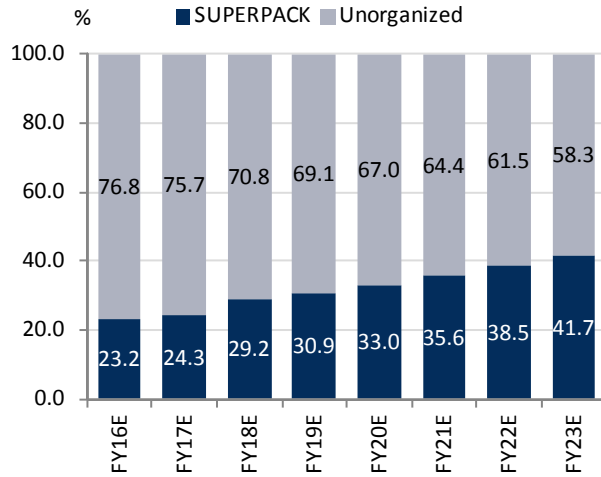
SUPERPACK's est. wedding share



Source: HDFC sec Inst Research

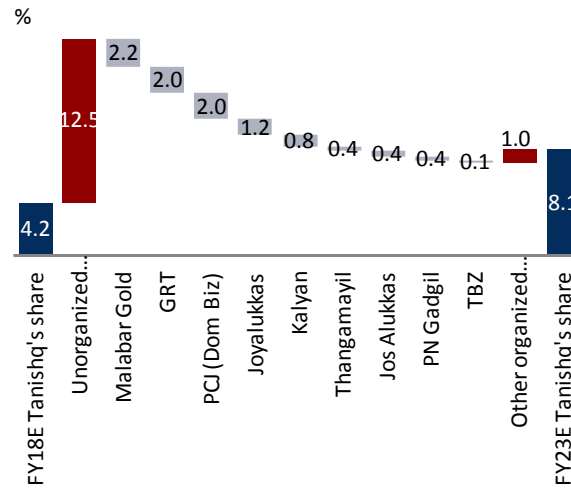
SUPERPACK to corner over 40% of the market; tanishq to double its market share

SUPERPACK's share to touch 42% by FY23E



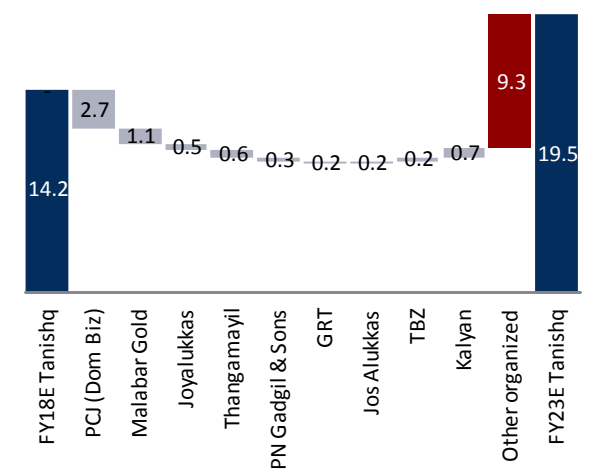
Source: HDFC sec Inst Research

Tanishq to nearly double its share by FY23E



Source: HDFC sec Inst Research

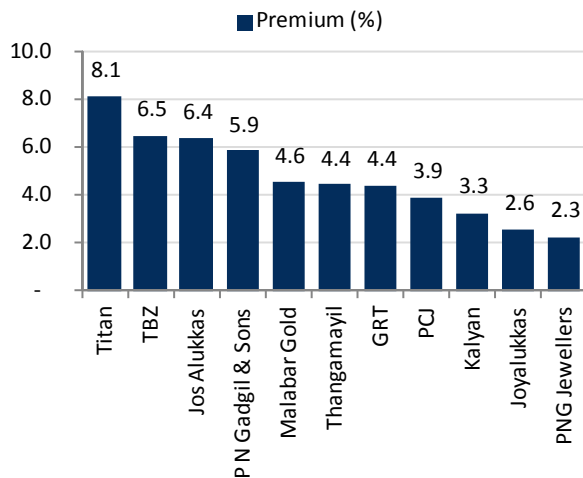
Tanishq to lead the SUPERPACK (mkt share)



Source: HDFC sec Inst Research

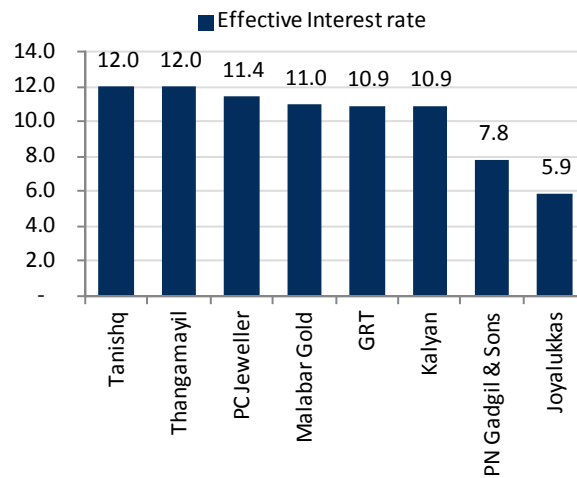
Design will be key; as offerings across the SUPERPACK converge with time

Player-wise premium over MCX



Source: HDFC sec Inst Research

Effective interest rate on gold schemes



Source: HDFC sec Inst Research

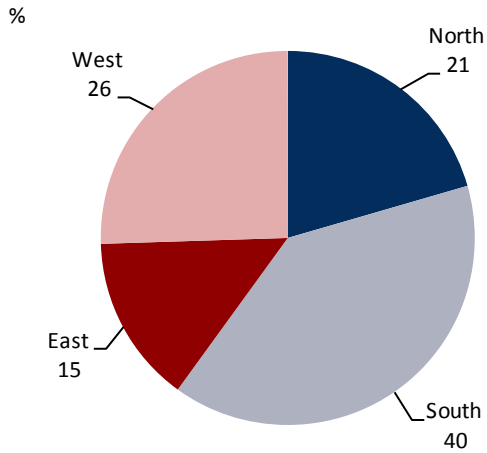
Old Gold Repurchase/Exchange commissions

Jeweller	Repurchase for Cash (commission %)		Old Gold Exchange (commission %)	
	Own gold	Other jewellers	Own gold	Other jewellers
Titan	3%	NA	0%	2%(22k) / 8%(below 22k)
PCJ	3%	NA	0%	1%
TJL	3%	3%	0%	
TBZ	3%	NA	0%	3%
Kalyan	1%	NA	0%	6%
P N Gadgil & Sons	3%	NA	0%	
GRT	3%	NA	0%	

Source: HDFC sec Inst Research

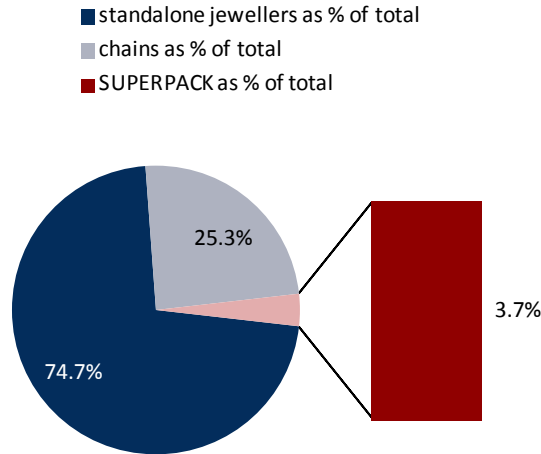
North and West – the bone of contention as South well-entrenched with a cap on profitability

Zone wise revenue split (estimated)



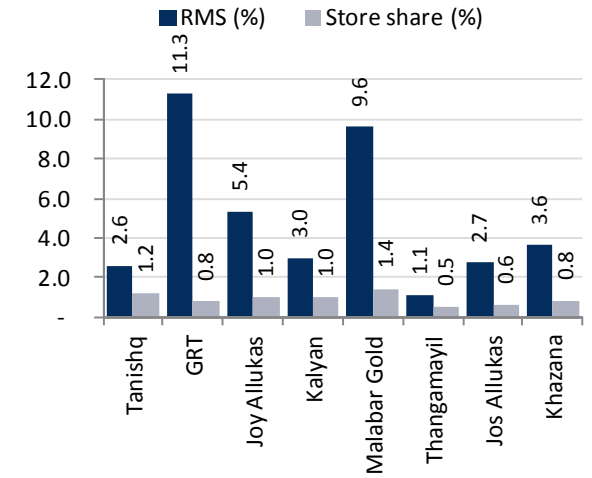
Source: HDFC sec Inst Research

SUPERPACK’s presence <4% in North/West



Source: HDFC sec Inst Research

Top jewellers enjoy ~40% market share down South



Source: HDFC sec Inst Research

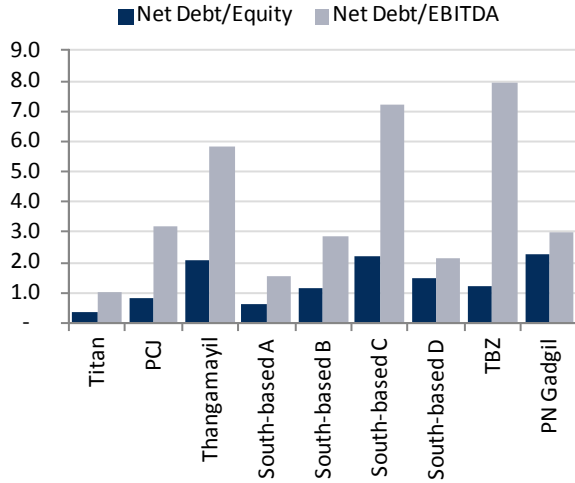
Top Jewellers expansion strategies

	Expansion Route	FY19 Store additions commentary
Tanishq	Mix of Owned & Franchisee	40-45
PC Jeweller	Mix of Owned & Franchisee	~25
Malabar Gold	Mix of Owned & Franchisee	~30
Senco Gold	Mix of Owned & Franchisee	NA
Kalyan Jewellers	Owned store	~20-25
Joyalukkas	Owned store	~20
GRT	Owned store	~5
Thangamayil	Owned store	~5
TBZ	Mix of Owned & Franchisee	~15

Source: HDFC sec Inst Research

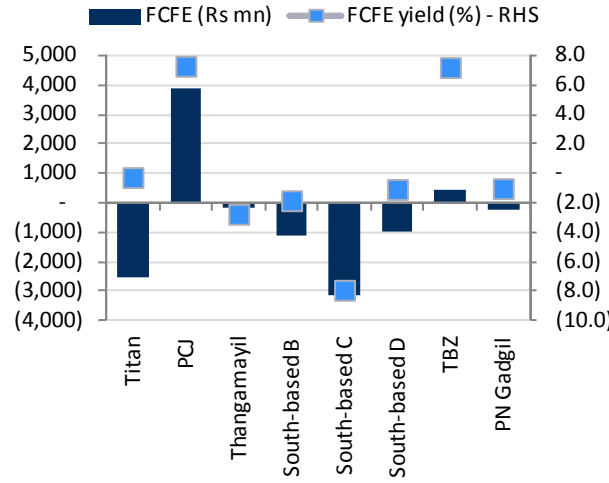
Capital – The Achilles heel for Titan’s peers; arbitrage to dwindle over the next two-three years

Leverage : Select jewellers



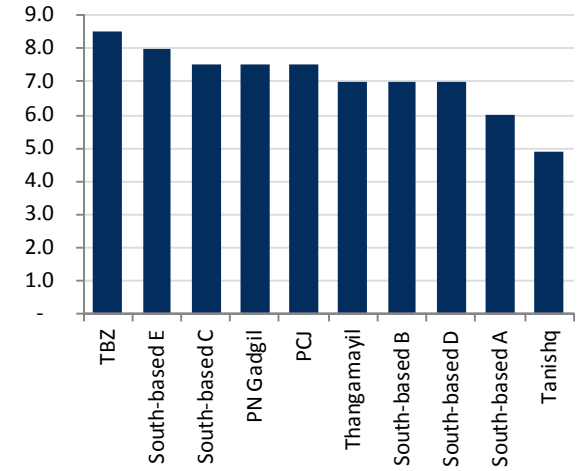
Source: HDFC sec Inst Research

FCFE : Select jewellers



Source: HDFC sec Inst Research

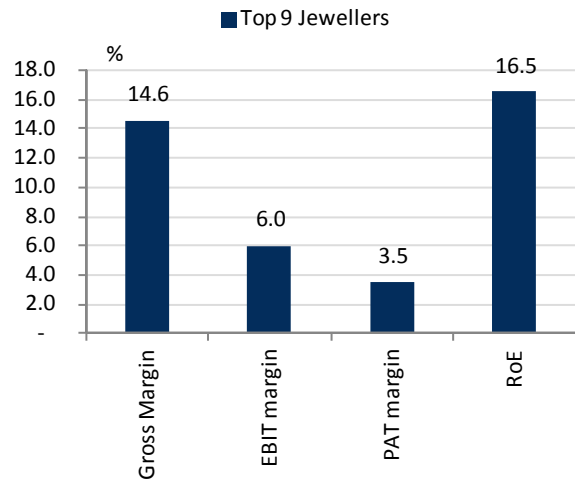
Avg. cost of debt : select jewellers



Source: HDFC sec Inst Research

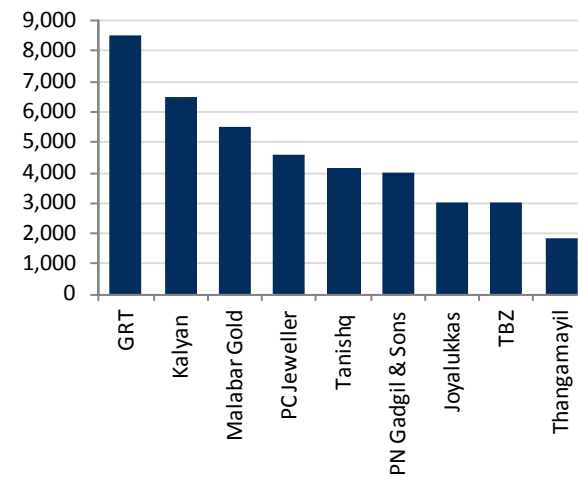
Key vitals of top jewellers remain stable

Key vitals of top jewellers



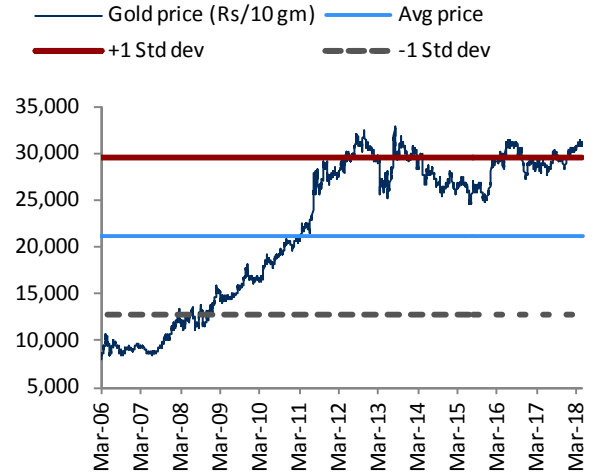
Source: Company, ROC, HDFC sec Inst Research; above universe estimated to account for 20% RMS

Player wise average store size



Source: HDFC sec Inst Research

Gold price near its six years peak



Source: HDFC sec Inst Research

Competitive positioning of key jewellers

	GRT	Joyalukkas	Kalyan	Malabar Gold	PN Gadgil	PCJ (Dom Biz)	Tanishq	TBZ	Thangamayil
Design Portfolio									
Tonnage									
Expansion strategy									
Margins									
Working capital efficiency									
Balance Sheet strength									
Return Profile									
Presence									
Gold sourcing strategy									
Wedding share									
Geographic reveunue split	South - 100%	South - 90% ROI - 10%	South - 45% ROI - 55%	South - 90% ROI - 10%	West - ~98% South - ~2%		NA		South - 100%
Geographic Store split	South - 100%	South - 80% North - 10% West - 10% East - Nil	South - 67% North - 15% West - 13% East - 5%	South - 87% North - 5% West - 7% East - 1%	West - 96% South - 4%	South - 4% North - 70% West - 14% East - 12%	South - 28% North - 31% West - 25% East - 17%	South - 11% North - 3% West - 70% East - 16%	South - 100%
No. of stores (#)	46	78	90	99	25	93	253	37	32



Source: Company, HDFC sec Inst Research

Peer Comparison : Premium to global peers justified given the growth and return profile

Company	Market Cap (USD mn)	Revenue (USD mn)			Revenue CAGR (FY18 - FY21E)	EBITDA (USD mn)			EBITDA CAGR (FY18 - FY21E)	PAT (USD mn)			PAT CAGR (FY18 - FY21E)	P/E			ROE (%)		
		FY19E	FY20E	FY21E		FY19E	FY20E	FY21E		FY19E	FY20E	FY21E		FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
India																			
Titan	11,711	2,919	3,477	4,118	20.2%	311	385	468	24.6%	208	253	303	22.6%	56.3	46.3	38.6	25.2	25.7	25.9
PCJ	778	1,668	1,951	2,297	17.6%	173	205	250	20.5%	115	134	163	27.3%	7.3	6.2	5.1	19.3	19.7	19.7
Thangamayil	94	243	286	334	18.1%	11	14	17	23.8%	4	6	7	30.7%	21.6	15.3	12.2	16.0	19.5	20.9
TBZ	90	275	301	330	8.7%	12	14	16	12.8%	4	4	6	21.2%	24.3	21.1	16.7	5.3	5.9	7.1
Global																			
Tiffany	16,601	4,524	4,746	4,998	6.2%	1,066	1,147	1,233	7.2%	583	645	707	11.0%	28.5	25.8	23.5	17.7	19.9	18.4
LUK Fook Holdings	2,742	1,984	2,119		7.9%	232	255		11.4%	172	189		12.0%	15.9	14.5		13.9	14.2	
Signet Jewellers	2,579	6,022	5,896	5,701	-3.0%	512	501	549	-9.1%	232	209	258	-15.1%	11.1	12.3	10.0	9.7	6.1	12.3
Chow Tai Fook Jeweller	12,548	7,864	8,469		13.2%	987	1,105		15.4%	626	706		15.5%	20.1	17.8		14.9	15.8	

Source: Company, Bloomberg estimates, HDFC sec Inst Research

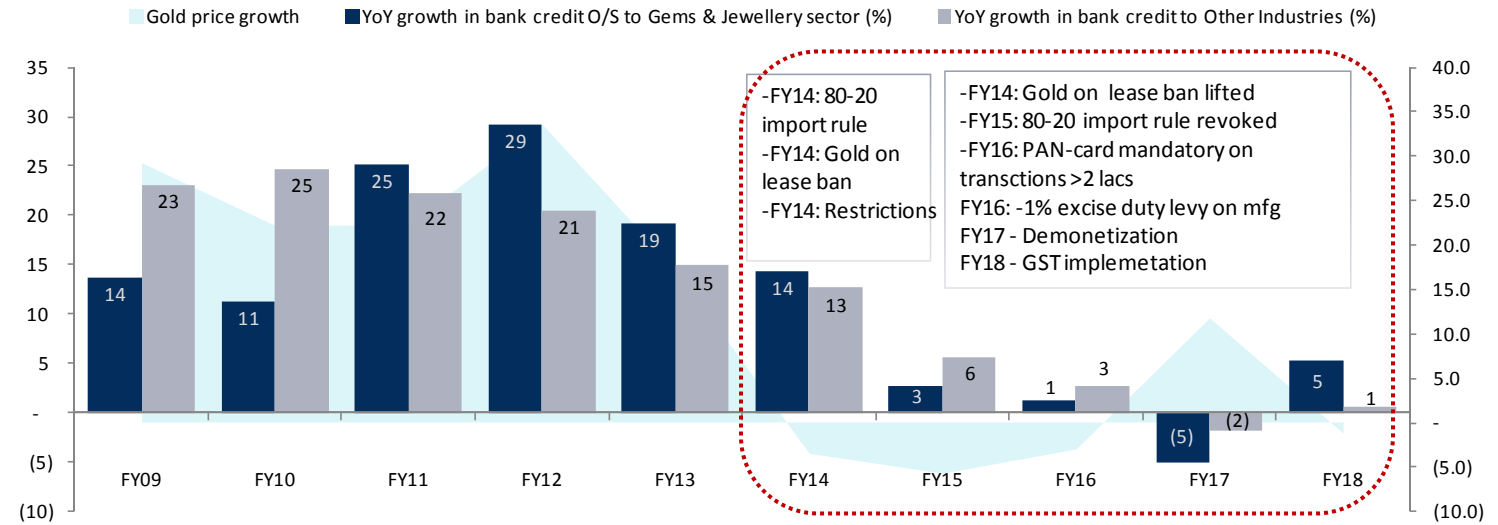
Jewellery -Valuation Table

Company	CMP	Mcap (Rs bn)	Reco	TP	EPS			P/E (x)			RoE (%)			RoIC (%)			RoCE (%)		
					FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Titan	897	804	NEU	820	15.9	19.4	23.2	56.3	46.3	38.6	25.2	25.7	25.9	19.3	19.7	19.8	18.1	18.3	18.3
PC Jeweller	136	58	NR	NA	20.4	23.9	28.9	7.3	6.2	5.1	19.3	19.7	19.7	11.2	11.6	12.2	10.6	11.4	11.5
Thangamayil	483	7	BUY	650	21.0	29.6	37.1	21.6	15.3	12.2	16.0	19.5	20.9	9.4	11.9	12.4	8.2	9.1	9.5

Source: Company, HDFC sec Inst Research

Waiting for 'normal' times

Industry could use some normal, post the FY14-18 drama



Source: Bloomberg, HDFC sec Inst Research

- Industry dynamics have oscillated from being favorable to unorganized jewellers (FY13-15) to being favorable for organized jewellers (FY15-till date), given the spate of regulatory events. The recent defaults by well-known jewellers (Nirav Modi and Geetanjali) haven't helped the industry's image amongst lenders, either. **With the 5-year drama behind, the Indian Jewellery industry could use some 'normal'.**
- Multiple unfavorable regulations such as the ban on gold on lease (Jul-13) and imposition of the 80:20 import rule (Aug-13) had severely impacted the financial health of organized jewellers as working capital needs (and consequently debt) increased. **Jewellers had to purchase raw material (gold)**

upfront. This bloated up the capital employed and put the returns profile of jewellers under pressure. The capping of Gold deposit schemes to 25% of networth and the interest that can be paid on such schemes (Apr-14) further added to the woes of organized jewellers.

- Second phase of regulations has decisively been in favor of organized jewellers – 1. 80:20 import rule revoked (Nov-14), 2. Ban of Gold on lease was revoked (Feb-15), 3. The cap on Gold deposit schemes also have been revised upwards to 35% of networth (FY17). Mandatory hallmarking (to be implemented soon) too is expected to aid the unorganised to organised shift.

A road fraught with frauds

Year	Scams	Description
FY18	Nirav Modi - Mehul Choksi PNB fraud (Feb 2018)	Nirav Modi and Mehul Choksi acquired fraudulent letters of undertaking from PNB for overseas credit from other Indian lenders, defrauding a bank of more than Rs 113 bn.
FY18	Nathella Sampath jewellery fraud (Mar 2018)	Promoters and directors of Chennai-based Nathella Sampath Jewelry Pvt Ltd (NSJPL) defrauded three banks namely SBI, Union Bank and HDFC Bank of Rs 3.8 bn. Nathella Sampath Jewelry misrepresented financial statements from 2010 and liquidated the primary asset kept as security/collateral.
FY18	Kanishk Gold scam (Mar 2018)	Kanishk Gold Pvt Ltd (KGPL) allegedly falsified records and financial statements to get loans from the banks over a 10 year period beginning 2008, defrauding a consortium of 14 banks led by the SBI to the tune of Rs 8.25 bn
FY17	Shree Ganesh Jewellery house (2017)	Shree Ganesh Jewellery House cheated a consortium of 25 banks, including 20 nationalised ones, of over Rs 22 bn. It was alleged that the accused had defrauded the banks through diversion of funds, fraudulent exports to shell companies in Hong Kong, Singapore and the UAE.
FY13	Winsome Diamonds and Jewellery (2013)	Winsome diamonds group defrauded consortium of banks of more than Rs 65 bn. Hasmukh Shah, an ex-director and authorised signatory of Winsome Diamonds group was allegedly orchestrating the export-import operations of the company and was also allegedly liasoning with the banks.

Source: Industry, HDFC sec Inst Research

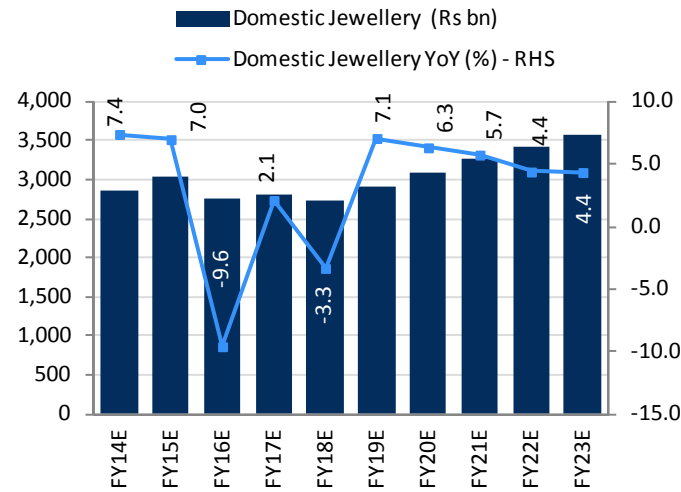
Our Industry model pegs the domestic gems & jewellery consumption at Rs 3.2tn, of which the domestic jewellery market is estimated at Rs 2.7tn (est to have grown at ~6.5% CAGR over FY11-18 largely driven by pricing/mix)

Domestic jewellery pegged to grow at a similar rate (~6%) over FY18-23. Gold volume expected to remain stable (1.5% CAGR) as unorganized jewellers increasingly get marginalized courtesy the governments push to formalize the sector.

Gold prices are near its 6-year peak.

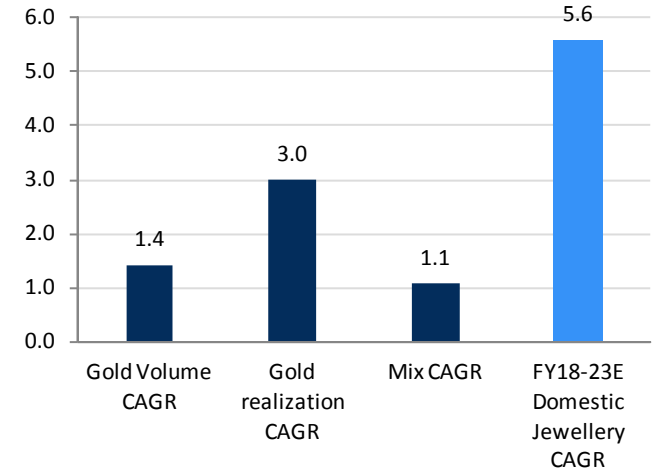
No expert on gold prices, however, when Brent crude inches up; gold prices follow suit. Expect gold prices to remain elevated given the deteriorating macros.

Domestic Jewellery to grow at 6% CAGR (FY18-23E)



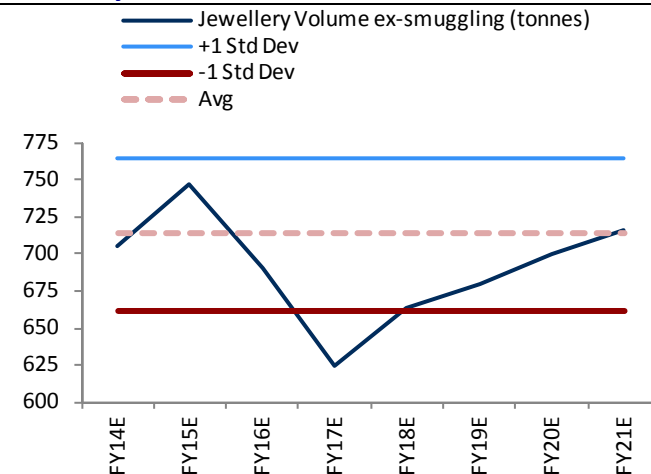
Source: Company, HDFC sec Inst Research

5-year drivers for domestic jewellery industry



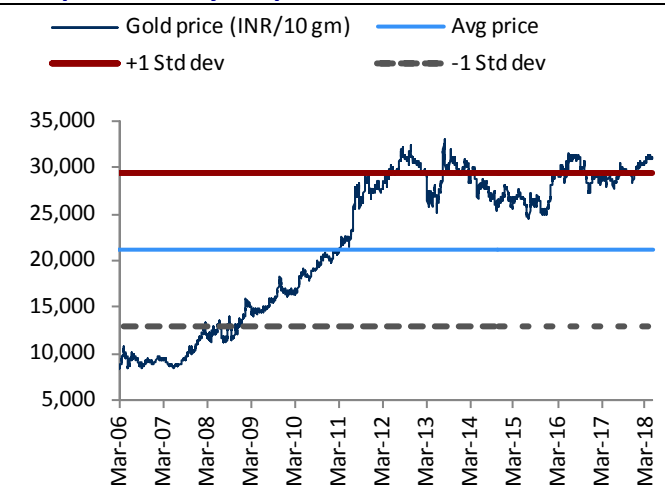
Source: Company, HDFC sec Inst Research

Jewellery volumes to mean revert



Source: Company, HDFC sec Inst Research

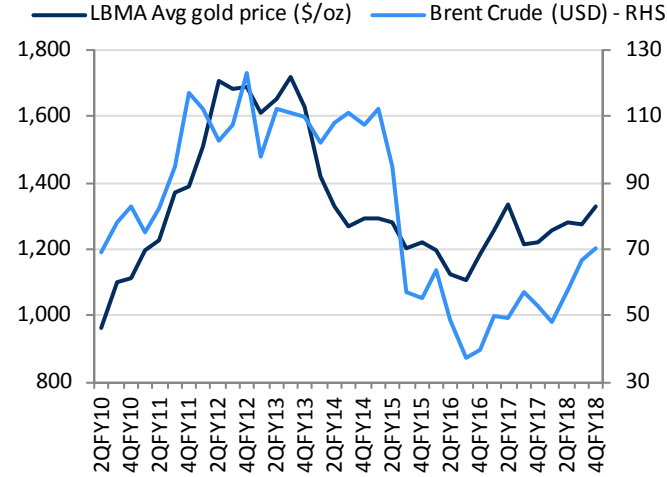
Gold prices at 6-year peak



Source: Company, HDFC sec Inst Research

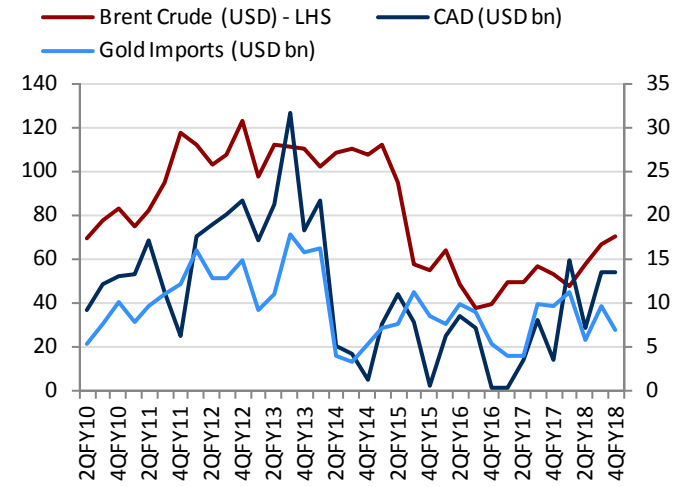
No expert on gold prices, however, when brent crude inches up; gold prices follow suit. Expect gold prices to remain elevated given the deteriorating macros.

Gold prices – A high correlation with Brent Crude



Source: Bloomberg, HDFC sec Inst Research

Gold imports (USD bn) vs Brent Crude



Source: Bloomberg, HDFC sec Inst Research

Mom & Pop jewellers: really squeezed?

Beyond demonetisation and GST...

- Myth vs reality:** It is assumed that GST will inevitably lead to massive and quick business migration. While this may be true for many sectors, it may hold less relevance in jewellery. What matters more is (1) How long is the supply chain? (2) Does GST really hit margins and business processes of unorganized jewellers?
- Shorter B2C supply chain helps unorganized play:** The shorter the B2C supply chain the easier it is to keep the entire transaction outside the organized trade (as long as gold sourcing is guaranteed through unofficial channels). The B2C supply chain in jewellery is relatively short with two (or at most three) levels (manufacturers who sell jewellery to wholesalers or retailers) ahead of consumers.

The unorganized sector continues to source gold via illegal channels. These include smuggling and exchange/recycling. The ex-SUPERPACK exchange + smuggling market is ~250-300 tonnes p.a. Multiple retail invoicing, fake invoicing and other methods are employed to skip the organized route to business. Cash is the medium of exchange, obviously.

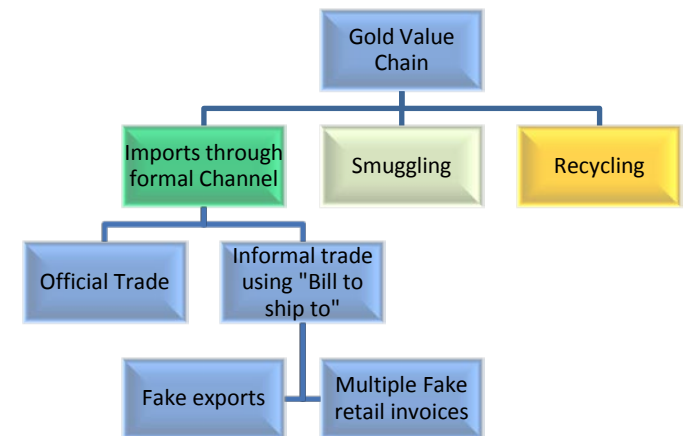
A part of official imports also find its way into the informal chain through 'Bill-to-ship' mechanism wherein the delivery of gold happens to one individual and the transaction is billed to another. There are two ways to do this: (1) Paper Exports: exports shown on paper but physical gold enters the unorganized channel, and (2) Multiple retail invoicing: to circumvent the PAN card requirement for transactions > Rs 200k, small jewellers prepare

multiple retail invoices. **Our walks through Karolbagh (Delhi) and Jhaveri Bazaar (Mumbai) gave us enough evidence of these malpractices!**

- Easy to manage input-output ratio for Diamonds:** The input-output ratio in converting rough diamonds into polished ones varies as much as 30-60% of the input. Also, diamond pricing remains fuzzy, unlike gold where purity (and hence price) is easy to establish. This gives diamond polishers and jewellery makers an opportunity to officially show low output and sell the rest through the informal chain.

Hence, while the events (GST and demonetisation) were enablers and may aid in the unorganized to organized shift in jewellery, the pace of shift may be more secular.

Domestic gold sourcing routes



Source: HDFC sec Inst Research

Nuclear families on the rise. This coupled with migration to tier 1 cities is a strong catalyst for share gain from family jewellers.

SUPERPACK to clock 12% revenue CAGR over FY18-23E and corner 42% of the domestic consumption by FY23

Top 6 jewellers to nearly corner one-third the market

- **Hallmarking squeezing mom-and-pop jewellers:** Our interactions across jewellery chains and mom-and-pop jewellers across India suggests that while hallmarking is yet not mandatory, consumers are increasingly insisting on hallmarked jewellery. This has increased the cost of procurement for jewellers and the ~25-30% pricing arbitrage between jewellery chains and standalone jewellers is shrinking. A back-of-the-envelope calculation in the table below gives a perspective of how the mom-and-pop jeweller is getting squeezed due to hallmarking.

Back-of-the envelope calculation suggests mom-and-pop jeweller getting squeezed

	Transaction		
	Without Hallmarking	Premium halved With Hallmarking	Premium maintained With Hallmarking
Gold Price (Rs/g)	3,100	3,100	3,100
Karat	21.0	22.0	22.0
Purity (%)	87	92	92
Cost-based on purity (Rs/g)	2,711	2,840	2,840
Pricing Premium (%)	6	3	6
Board rate for consumer (Rs/g)	2,873	2,925	3,010
Making Charges (Rs/g)	150	195	195
Making charges (%)	5.2	6.7	6.5
Retail Price (Rs/g)	3,023	3,120	3,205
Gross Profit (Rs/g)	313	280	365
Gross Margin (%)	10.3	9.0	11.4
Organized Jeweller Gross margin in north/west (%)	13-15		
Organized Jeweller Gross margin in South (%)	8-10		

Source: HDFC sec Inst Research

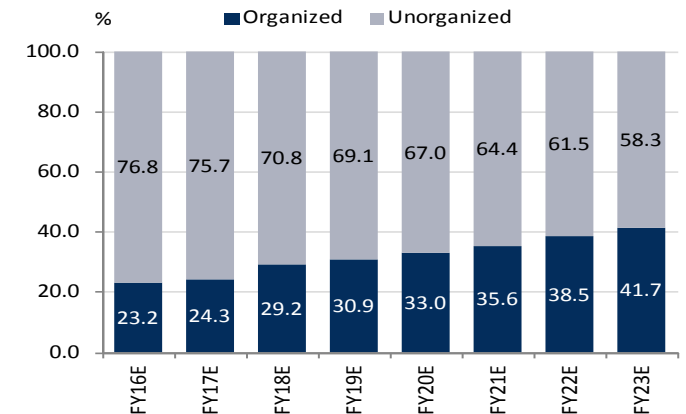
- **Indian households are getting nuclear:** One of the major shifts underway is that the avg Indian household is increasingly getting nuclear with urbanisation, esp. towards tier 1 cities. This remains a strong catalyst for the shift from family jewellers to organized chains.

Family Type Distribution – All HHs (%)	IRS 2013	BI 2016
Joint Family	26	22
Nuclear Family with Elders	17	17
Nuclear Family w/o Elders	53	58
Living Alone	4	3

Source: BARC, HDFC sec Inst Research

- **SUPERPACK to grow at over 12% over FY18-23E:** Given some of the above tailwinds for the organized jewellers coupled with the design spread they offer, we expect our SUPERPACK (comprising 17 Top Jewellers) to grow at over 12% CAGR over FY18-23E. (est. ~11% CAGR over FY16-18E). They will gain avg ~250bps/year in market share over FY18-23E to hit ~42% (vs ~29% currently)

SUPERPACK’s share to touch 42% by FY23E

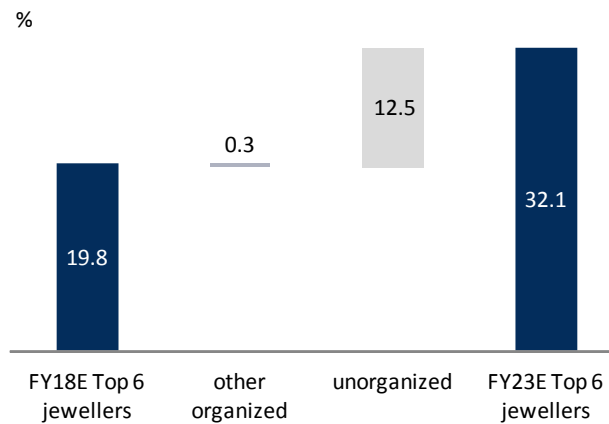


Source: BARC, HDFC sec Inst Research

Note: We don't have a categorical definition of unorganized jewellers and focus only on how the SUPERPACK performance is expected to pan out.

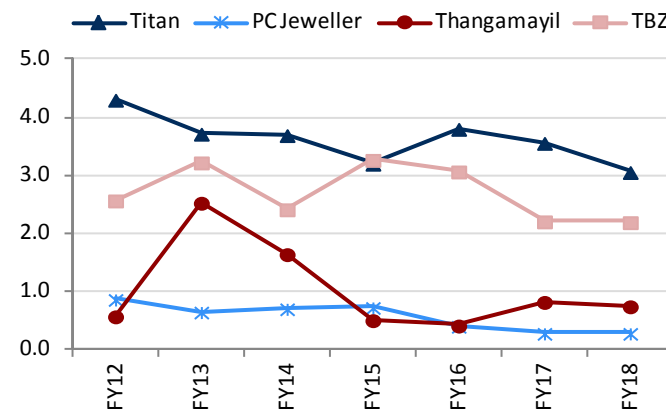
- Top 6 to corner one-third the market:** The top 6 jewellers in India account for 4-5% of the BIS-listed stores and command ~20% revenue market share (RMS). Given their ambitious expansion over the next 5 years, RMS-to-store ratio is expected to expand further. We expect them to account for nearly one-third of the domestic consumption (Jewellery + Investment) in India by FY23E.

...of which the top 6 will have ~1/3 mktshare



Source: Company, HDFC sec Inst Research

Player-wise ad spends (% of sales)

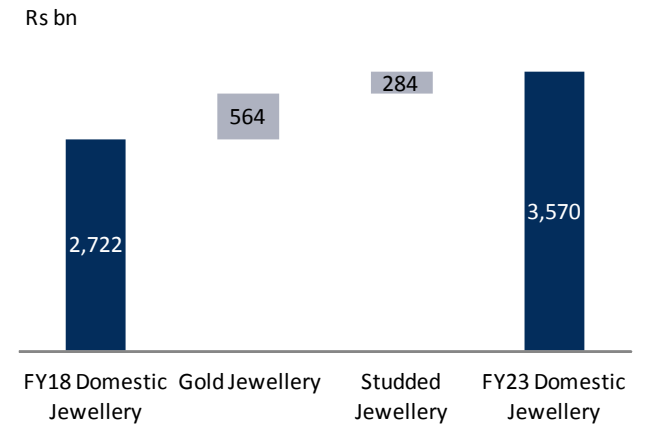


Source: Company, HDFC sec Inst Research

Launch of new stores in new regions will keep marketing investment elevated as top jewellers focus on brand building. This however could be a strong footfall pulling tool.

- Gold jewellery is the big chunk of spend:** Falling diamond prices will underpin this trend. We expect nearly two-thirds of the growth over FY18-23E to come from plain gold jewellery sales.

Gold/Studded contribution to industry growth



Source: Company, HDFC sec Inst Research

Celebrity endorsements

Jeweller	Brand ambassador
Tanishq (Titan)	Deepika Padukone
PC Jeweller	Akshay Kumar, Twinkle Khanna
TBZ	Vaani Kapoor
Kalyan	Katrina Kaif, Amitabh Bachchan
PN Gadgil Jewellers	Salman Khan
Malabar Gold	Manushi Chhillar

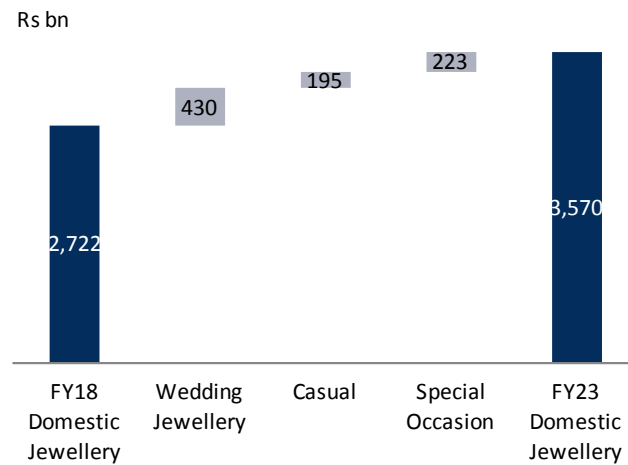
Source: Company, HDFC sec Inst Research

Weddings : the bedrock of demand

- Where would jewellery be without brides!** Weddings remain the bedrock for gold jewellery demand in India. With an estimated ~8-10mn weddings in India and an average ticket size of ~Rs 200k, the wedding market itself is pegged at over Rs ~1.6tn (~58% of domestic jewellery sales). The age-old concept of 'Streedhan' (property/assets given to the bride for

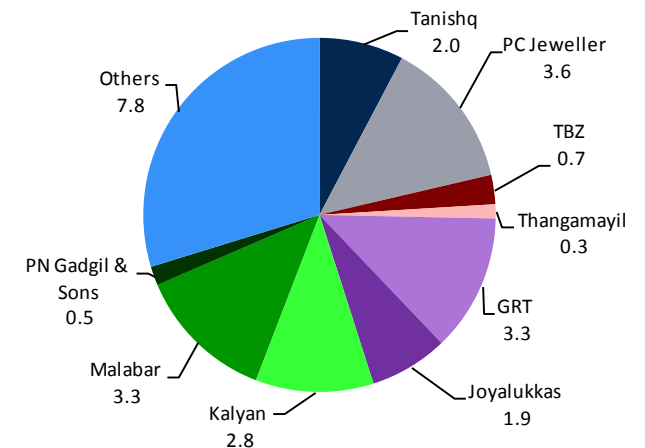
security at the time of her wedding) remains deep-rooted in India and consequently lends inelasticity to demand from this segment. We expect the wedding segment to add over half the incremental industry growth. As is well known, this is a weak spot for Titan. However, Titan is putting its best foot forward to correct this.

Wedding to add over half of incremental growth



Source: HDFC sec Inst Research

Est. wedding share of key jewellers



Source: Company, HDFC sec Inst Research

Studded jewellery expected to grow at 11% CAGR over FY18-23E as SUPERPACK pushes through aggressive diamond activation programmes

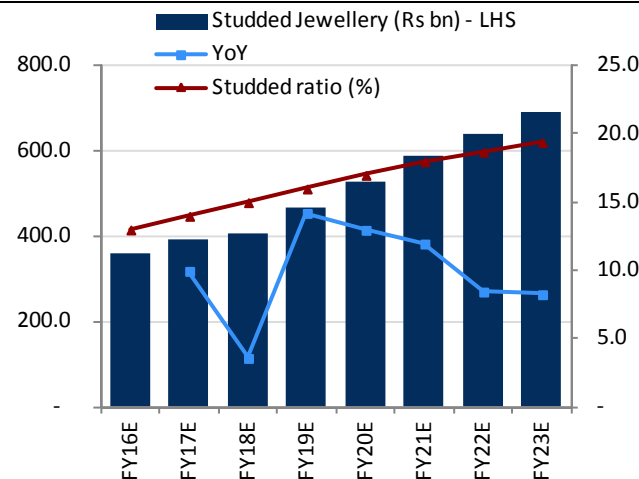
Studded jewellery increasingly competes with other indulgent discretionary. This coupled with perception of falling diamond prices may keep the Indian from loosening her purse strings in a meaningful way. We do not factor this risk yet

- Studded jewellery remains healthy:** We believe the ~Rs 40bn studded jewellery market (est. 9-10% CAGR over FY13-18) is expected to remain healthy as the SUPERPACK push studded jewellery through an aggressive sales push, including attractive return policies. While urban centres (especially in the north & west) will boost studded jewellery off-take, the predisposition towards purchasing plain gold jewellery remains strong in heartland India. Hence blow-out growth in the studded category is unlikely. We assume a generous 11% CAGR in aggregate studded revenues over FY18-23E.

- ...but falling diamond prices pose risk :** Diamond prices have halved since peaking in Sep-11. This was largely a function of supply outstripping demand. The midstream in the value chain ended up with excessive inventory pile up during the period, which led to De Beers – the world’s largest diamond miner recalibrating its production and prices.

Prices have stabilized since FY17. While the motive a studded jewellery purchase is typically driven by gifting (thereby insulating it somewhat from diamond price movement), the category competes with other hi-ticket consumer discretionary spends such as automobiles, gadgets, travel, home-décor, etc.

India: Estimated studded ratio trends



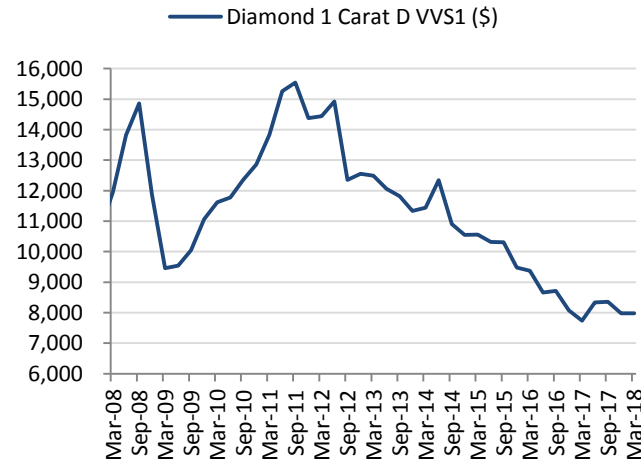
Source: HDFC sec Inst Research

...Key jewellers' studded ratio:

Tanishq	30
PC Jeweller	30
TBZ	23
Joyalukkas	20-22
Kalyan Jewellers	18-20
Malabar Gold	9-12
GRT	3-4
PN Gadgil & Sons	3.2
Thangamayil	0.4

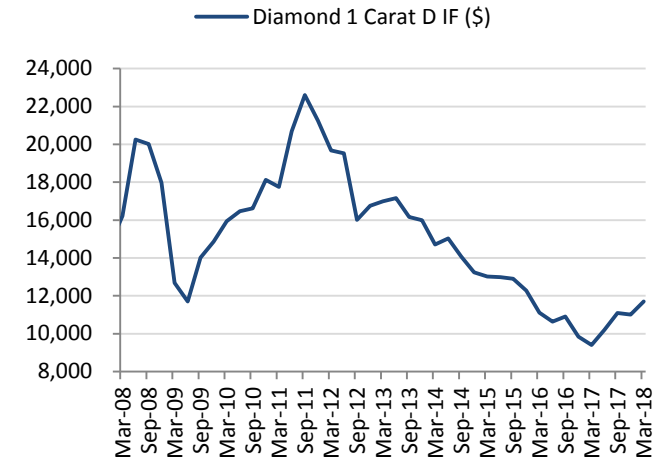
Source: Company, RoC, DRHP, HDFC sec Inst Research

Diamond Prices (USD/carat) for VVS1 diamonds



Source: Bloomberg, HDFC sec Inst Research

Diamond Prices (USD/carat) for IF diamonds



Source: Bloomberg, HDFC sec Inst Research

Different strokes for different folks

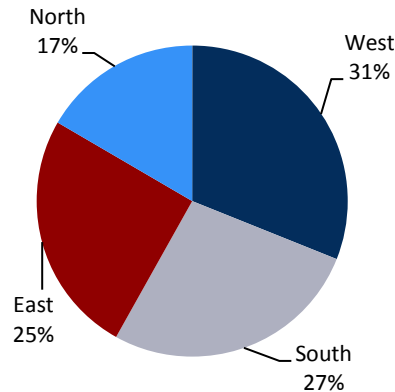
South market is mature, majors will tread out

- As part of our pan-India jewellery tour, we met unlisted jewellery chains and visited their flagship stores to gauge the competitive landscape, growth strategies and spot winners.

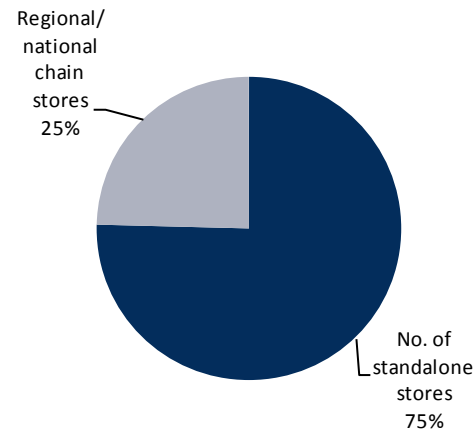
Our findings : (1) Most south-based national/regional chains concur that incremental market share will be earned through expansion into the North and West regions, (2) Most South players prefer the owned store model vs. the franchisee model. Also pace of expansion may be slower vs. Titan for a couple of years given capital constraints, (3) Given the predominantly South-based footprint of key peers, Tanishq’s national design width will give it an advantage for now. But it is not a durable hurdle and will dwindle over time.

- South well-entrenched, profitability capped:** The four (now five) southern states in India account for ~41% of the domestic consumption (est Rs 1.25tn) and ~27% of the BIS-listed stores. Consumer purchasing behavior gravitates towards traditional plain gold jewellery where margins are low. Major jewellers’ EBITDA margins hover in the 4-6% range. Key players (Tanishq, Malabar Gold, GRT, Joyalukkas, Kalyan, Jos Alukkas, Khazana, Thangamayil) are well-entrenched and are estimated to account for ~45-47% of the South market (in spite of ~10% share in store count). Given the higher penetration and lower profitability in South India, most major South-based jewellers concur that incremental market share gain will be through expansion in the north and west.

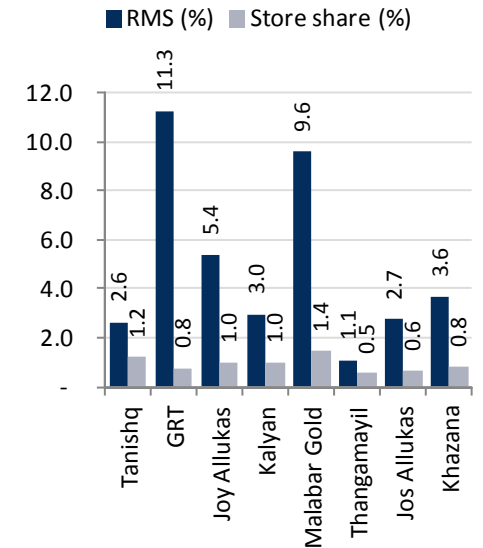
Zone-wise BIS-listed stores



SOUTH: Chains vs Standalone



...top jewellers enjoy ~40% market share down South



Source: BIS, HDFC sec Inst Research (Note: BIS-listed 21,778 stores used as sample to extrapolate industry behavior and performance)

- Own store expansion – Mantra down south:** Most South-based jewellers with national ambition intend to expand through own stores in the North and West. While there is little advantage in capital by opting for the franchisee model (over 95% of investment is towards inventory), we reckon the decision to go the owned store way is driven by (1) Most jewellers are yet to travel Tanishq’s learning curve in franchisee management, (2) Potential franchisees in the rest of India may also have limited appetite for tying up with South based chains as they foray into the North or West.

We believe key challengers will be better prepared after the next 2-3 years to push the franchisee throttle as the current capital and design arbitrage shrinks. There are exceptions, of course. For example, Malabar Gold intends to expand via the franchisee route. PCJ which already has a strong foothold in the north zone is expected to increasingly focus on pushing throughput via franchisees in the West.

Note Risks pertaining to franchisee model are: (1) Franchisee Capital erosion if gold prices decline, as most franchisees don’t enjoy gold on lease arrangement with banks, (2) Inventory management and design availability at franchisee stores, and (3) Standardization of customer experience

Top jewellers : Expansion strategies

Top Jewellers expansion strategies	Expansion Route	FY19 Store additions commentary
Tanishq	Mix of Owned & Franchisee	40-45
PC Jeweller	Mix of Owned & Franchisee	~25
Malabar Gold	Mix of Owned & Franchisee	~30
Senco Gold	Mix of Owned & Franchisee	NA
Kalyan Jewellers	Owned store	~20-25
Joyalukkas	Owned store	~20
GRT	Owned store	~5
Thangamayil	Owned store	~5
TBZ	Mix of Owned & Franchisee	~15

Source: Company, HDFC sec Inst Research

- Phase 1 - Advantage TITAN, Phase 2 - closely fought:** Our interactions with lenders also suggest that unencumbered cash levels and leverage warrant a capital infusion for some of the unlisted big-box jewellers, if they have to make any meaningful investments in the north and west (given their owned store expansion route. Given that credit flow will be cautious, Phase 1 (FY19-21E) will see levered jewellers either raising money through capital markets or will sit on the fence as less levered

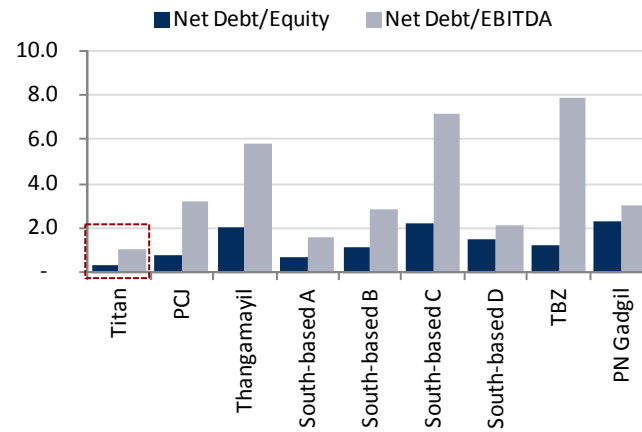
companies gain market share. This is expected to give Titan a 1-2 year head-start. This is also evident in Titan’s confidence of achieving its 25% jewellery revenue growth aspiration for FY19. **However, this capital arbitrage along with the design arbitrage will narrow down over the medium term.** Tanishq will find itself defending turf against some strong and able challengers across India, especially those with a wider national footprint.

Expected IPOs in the next 1-3 years

Kalyan Jewellers	South
Senco	East
Joyalukkas	South
PN Gadgil & Sons	West

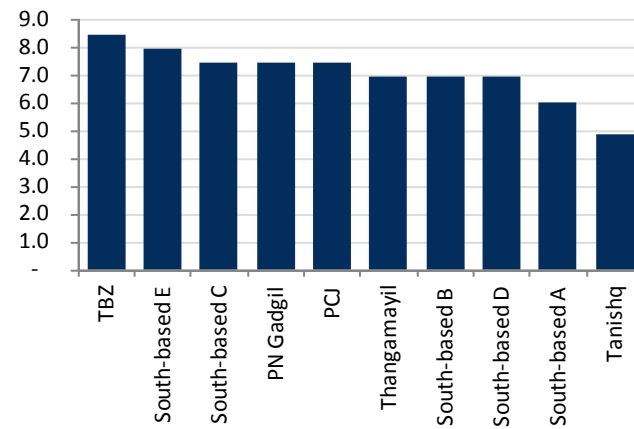
Source: Company, HDFC sec Inst Research

Titan: Leaner vs peers



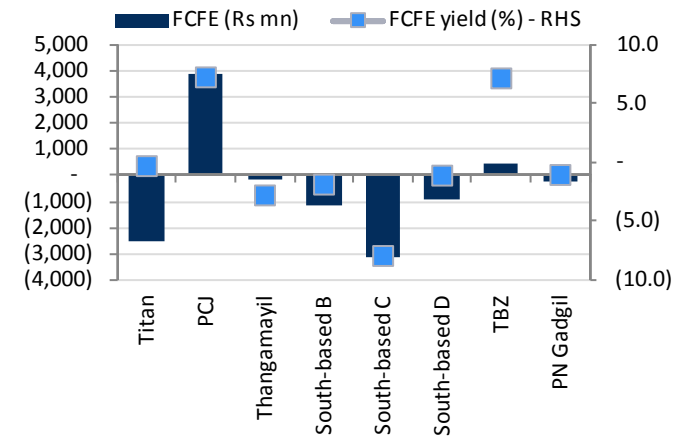
Source: Company, RoC, HDFC sec Inst Research

Player-wise estimated avg cost of funds (%)



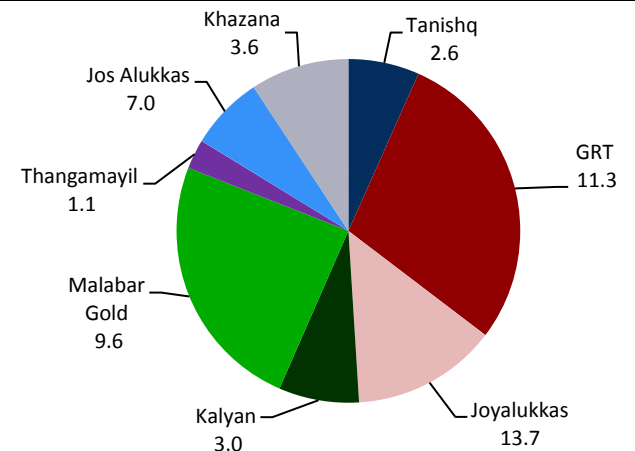
Source: Company, HDFC sec Inst Research

Player-wise FCFE profile



Source: Company, HDFC sec Inst Research, FY17 RoC for unlisted data

Est. rev share amongst top 8 jewellers down South

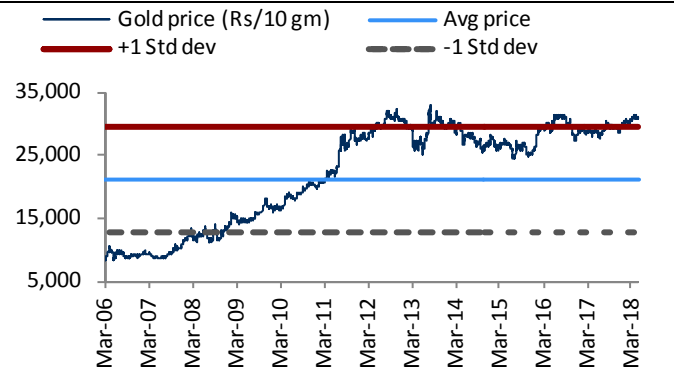


Source: Company, HDFC sec Inst Research

- Rising gold prices can drive franchisee throughput:**
 Not all franchisees of top jewellers employ the gold on lease method of sourcing gold (a natural hedge). Hence, their throughput and store inventory depends to some extent on their open position on gold. With deteriorating macros, we believe India has entered a stable-to-rising gold price environment. This makes it

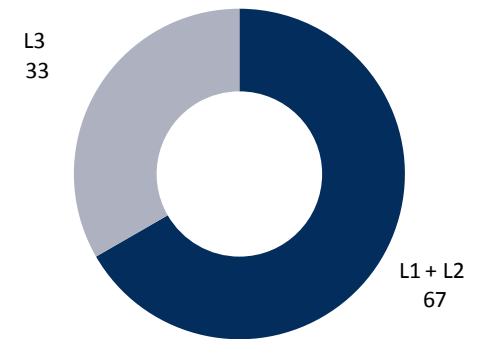
conducive for stoking up franchisee throughput. About a third of Titan’s jewellery revenue comes from its L3 channel (FOFO stores) which could see a pick-up in throughput. PCJ and Malabar Gold have kicked off franchisee operations with some franchisees procuring gold on lease from banks, thereby hedging their inventory.

MCX Gold price trends (Rs/10g)



Source: Company, HDFC sec Inst Research

Tanishq: Owned vs Franchisee stores (%)



Source: Company, HDFC sec Inst Research

Owned stores vs Franchisee store economics : a rough cut view

Particulars	Owned Stores	Franchisee Stores
Area (Sq ft)	3,500	2,000
Studded Ratio (%)	25	20
Revenue per sq ft	140,000	80,000
Revenue per store (Rs mn)	490	160
Gold Jewellery rev/store	368	128
Studded Jewellery rev/store	123	32
Franchisee margin (%) @ 50% of GM	0	7.5
Attributable Company revenue/store (Rs mn)	490	148
EBIT margin (%)	10	10
Attributable Company EBIT/store (Rs mn)	49	15
Capex per sq ft	4500	0
Capex per store (Rs mn)	15.75	0
Est. WC cycle (Days)	145	60
Working capital requirement	195	26
Total Investment (Rs mn)	210	26
RoCE (%)	23.3	56.3

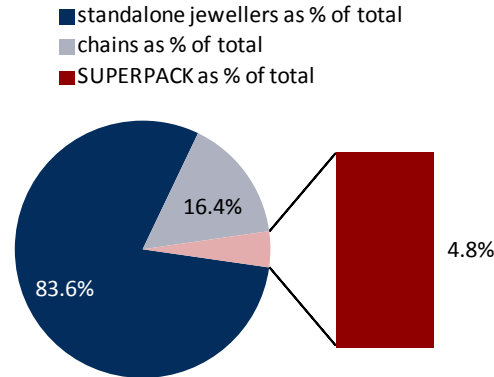
Company, HDFC sec Inst Research

North & West : The battlegrounds

The SUPERPACK accounts for under 4% of the stores in North and West (over 45% of domestic consumption)

- **Headroom to penetrate is higher :** The SUPERPACK accounts for a measly 3.5% of the BIS-listed jewellery

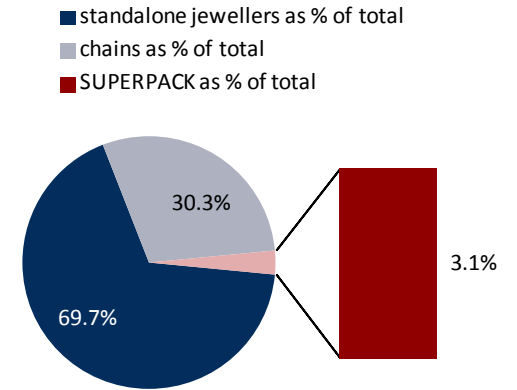
SUPERPACK occupy 4% outlet share in North



Source: BIS, Company, HDFC sec Inst Research

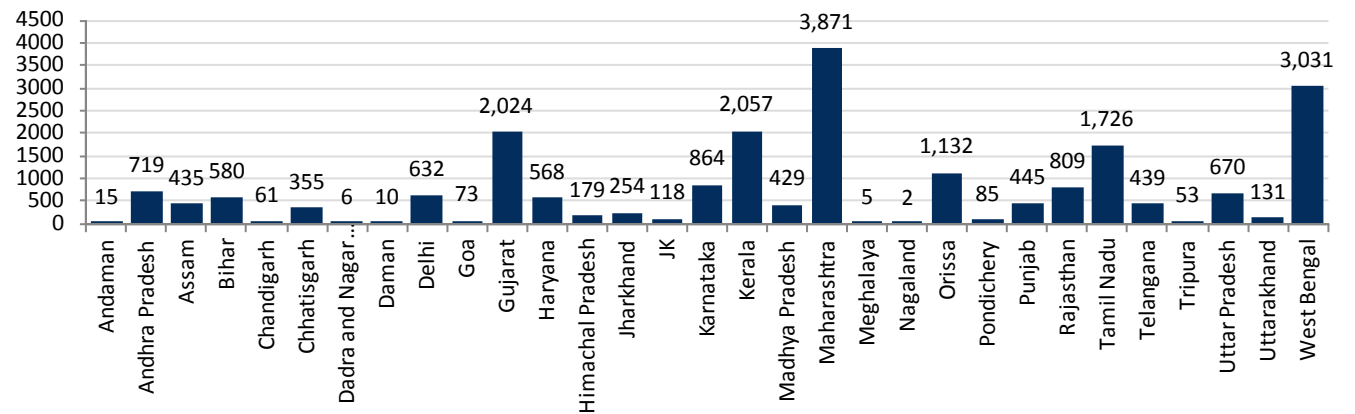
stores in North and West (vs ~8% in South). Some of the key jewellers in the North are Tanishq, PCJ, Kalyan, Senco. In the West it is Tanishq, TBZ, PN Gadgil & Sons, PNG Jewellers and Waman Hari Pethe.

...even lower at 3% in West Zone



Source: BIS, Company, HDFC sec Inst Research

State-wise BIS listed jewellery stores in India: surprisingly low nos. in some Southern states



Source: BIS, HDFC sec Inst Research

- Impulse purchases + higher studded = higher profits in North & West:** Consumers in the North & West region of India are more receptive to studded jewellery and impulse-led lighter-weight jewellery purchases (14k, 18k jewellery) viz-a-vis their southern counterparts. Plain gold jewellery typically enjoys gross margins ranging from 10-14%, while diamond-studded jewellery has gross margins of 30-35%. Consequently as studded ratio (studded jewellery/total revenue) goes up, profitability improves.

Retail sales by jewellery type

Category	% of retail sales	Range of weights (gm)	Avg. ticket weight (gm)
Necklaces	15%-20%	25-250	30-60
Bangles	30%-40%	8-25	10-15
Chains	30%-40%	10-50	10-20
Earrings	5%-15%	2-30	3-8
Finger rings	5%-15%	2-15	3-7

Source: WGC, HDFC sec Inst Research

Regional tastes in gold jewellery

	South	East	West	North
Market share	40%	15%	25%	20%
Caratage	22k	22k	22k, 18k, 14k	23k, 22k, 18k, 14k
Important centres	Chennai, Hyderabad, Cochin, Bangalore	Kolkata	Mumbai, Ahmedabad	New Delhi, Jaipur

Source: WGC, HDFC sec Inst Research

- Able challengers in the fray in North & West:** While Tanishq remains a distant leader in terms of presence, it has able challengers in PC Jeweller (North), Kalyan, Joyalukkas (South) and Senco (East) given their leading positions vs. other regional players. This does imply relatively better tie-ups with ‘karigars’. They may thus be closer to catching up with Tanishq on the design curve vs. other regional jewellers.

PCJ, Kalyan & TBZ have better width in presence amongst regional jewellers; South players to play catch up

Jewellers	Origin	North	East	West	South	Store share in region of origin	Store share in region of non-origin	Presence (No of States/UTs)	Presence (No of Districts)
Tanishq	National	78	46	59	71	NA	NA	26	156
PCJ	North	65	14	10	4	69.9	30.1	20	77
Kalyan	South	13	4	11	58	67.4	32.6	16	71
Joyalukkas	South	5	0	7	59	83.1	16.9	12	58
Malabar Gold	South	5	1	7	86	86.9	13.1	11	64
GRT	South	0	0	0	46	100.0	-	5	22
Jos Alukkas	South	0	0	0	38	100.0	-	5	30
Thangamayil	South	0	0	0	32	100.0	-	1	16
Khazana	South	0	0	0	49	100.0	-	5	31
TBZ	West	1	7	25	4	67.6	32.4	11	26
PN Gadgil & Sons	West	0	0	24	1	96.0	4.0	3	16
PNG Jewellers	West	0	0	22	0	100.0	-	3	13
Senco	East	9	74	4	4	81.3	18.7	14	48

Source: BIS, HDFC sec Inst Research

- PCJ has been the most aggressive in store expansion:** PCJ has been the most aggressive in network expansion. It has added 282k sq. ft of retailing space (CAGR ~20%) over FY12-18 vs Titan (ex-Caratlane) 620k sq. ft (CAGR 15%). The race will continue over the next 5 years as the SUPERPACK capitalizes on the weakening position of mom-and-pop jewellers. We believe PCJ will continue to add ~25 stores per year (75% via franchisee route), while

Titan intends to add ~150 stores over FY18-23E (~85% through the franchisee route). In the west, TBZ intends to increase its retail space from ~111k sq ft to 150k sq ft over the next 2-3 years. PN Gadgil & Sons expects to further deepen its presence in Maharashtra by adding ~15 stores over FY18-20E. **The Southern troika (Malabar Gold, Kalyan and Joyalukkas)** are expected to add ~20-30 stores each in FY19.

PN Gadgil (off a small base), PCJ and GRT have expanded aggressively

Area (sq. ft.)	FY13	FY14	FY15	FY16	FY17	FY18	5-yr CAGR	5-yr space addition
Tanishq (ex-caratlane)	608,628	720,123	812,928	902,928	957,407	1,079,742	12.1%	471,114
PC Jeweller	164,572	238,000	313,296	353,213	386,923	419,963	20.6%	255,391
Thangamayil	46,295	56,724	56,724	57,624	57,624	58,024	4.6%	11,729
TBZ	82,368	88,093	91,000	98,200	108,948	110,666	6.1%	28,298
PN Gadgil	28,412	42,363	53,220	56,256	66,702	100,213	28.7%	71,801
GRT	-	227,000	262,000	297,000	339,000	374,000	13.3%	374,000
Malabar Gold								
Joyalukkas						234,000		
Kalyan Jewellers						559,000		

Source: HDFC sec Inst Research

Design portfolio : Key factor

Given that most jewellers are inching towards parity in terms of gold pricing, monthly scheme offerings and repurchase/exchange commissions, the battle will eventually be fought over the breadth and depth of designs on offer.

- Prices converging across the SUPERPACK:** A decade ago, consumers would fork out a premium of 5-15% over the MCX gold price whilst purchasing from a top jeweller. Organized players merrily took advantage of consumers' ignorance. This is receding now. Titan's gold price premium (over MCX) has considerably shrunk to ~8% (May-18) vs ~15-16% in FY11 and 10% in Aug-15. As Titan pushes out its wedding collections

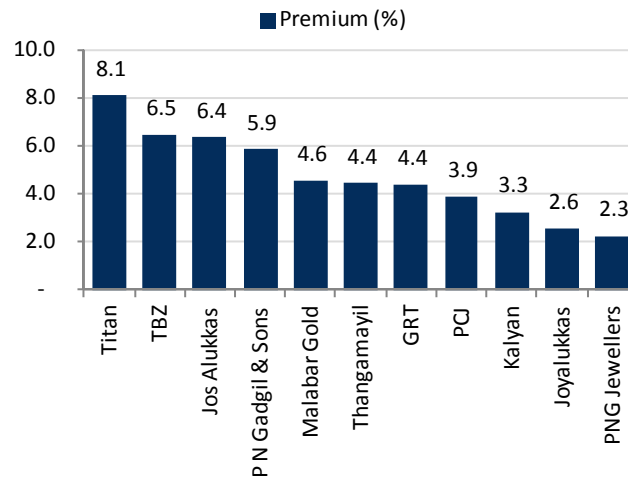
over the next 5 years, this spread can only reduce. Premia for other top jewellers are converging already, esp. if geographical differences in gold price are built in.

- Monthly gold schemes also converging:** Monthly gold investment schemes by organized jewellers seek to push market share. These have largely converged across the SUPERPACK. For jewellers, these are helpful as (1) Revenues are assured, (2) Working capital efficiency rises. The obvious trade-off is that the financing cost is higher than gold on lease (~3-4% p.a.), typically 6-12%.

Gold realizations, monthly scheme offerings, repurchase/exchange discounts converging across the SUPERPACK

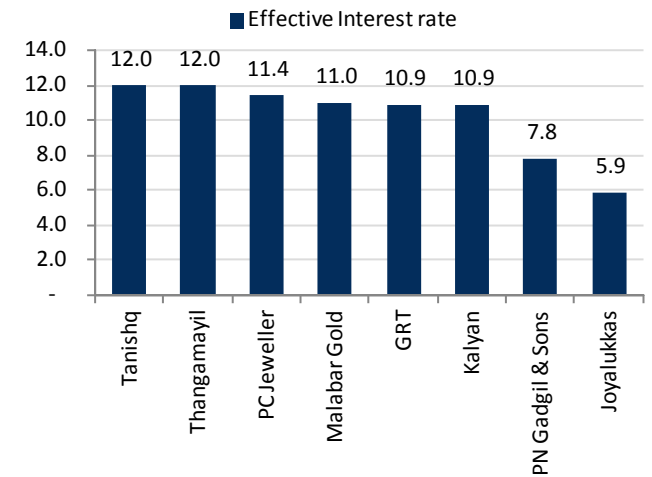
Hence, battle will be fought on designs in the medium-to-long term

Player-wise premium over MCX



Source: Company, HDFC sec Inst Research, as per 10th Jun 18

...Effective interest rate offered on gold schemes



Source: Website, Company, HDFC sec Inst Research

- Repurchase/exchange indicate similar trends:** Repurchase commissions are charged by jewellers if the latter wishes to sell/exchange old jewellery for cash or new jewellery. The commissions depend on (1) Type of transaction (repurchase or exchange), (2) Whether the jewellery is their own or that of other jewellers. These commissions are largely converging across key jewellers (see table). With mandatory hallmarking expected to be a reality soon, this

convergence can only accelerate. Also, with tighter credit (higher collateral and stricter Debt/Equity norms), we believe jewellers may focus on procuring more gold via exchange schemes, further driving down exchange pricing premia. Titan's stated strategy of increasing its exchanged gold mix from ~40% in FY18 to ~50% by FY23 is but an indication of this trend. Co has revised its old gold exchange scheme recently.

Player-wise: Old Gold Repurchase/Exchange commissions

Jeweller	Repurchase for Cash (commission %)		Old Gold Exchange (commission %)	
	Own gold	Against Other jewellers	Own gold	Against Other jewellers
Titan	3%	No repurchase	0%	2%(22k) / 8%(below 22k)
PCJ	3%	No repurchase	0%	1%
Thangamayil	3%	3%	0%	
TBZ	3%	No repurchase	0%	3%
Kalyan	1%	No repurchase	0%	6%
P N Gadgil & Sons	3%	No repurchase	0%	
GRT	3%	No repurchase	0%	

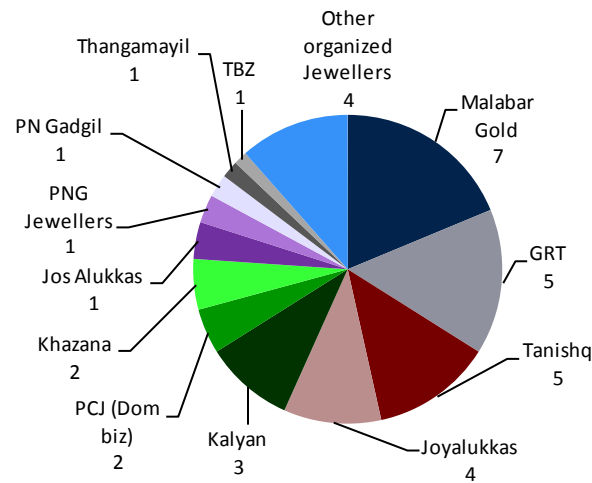
Source: HDFC sec Inst Research

Tanishq has a 1-2 year head-start vs peers on designs given its wider presence

Exchange programme is a good up-selling tool. Could push SSSG

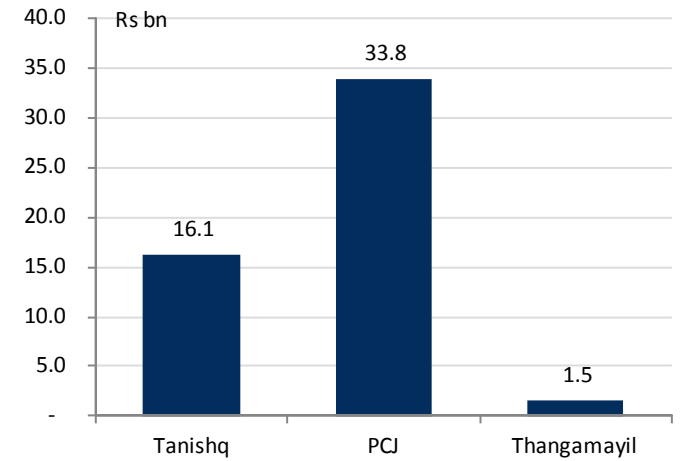
- **Tanishq leads on design, peers will catch up:** Two thirds of jewellery manufactured in India today is hand-crafted. Hence, (1) Strong tie-ups with Karigars for each region to cater to local tastes, (2) In-house manufacturing capabilities, (3) In-house design teams and/or tie-ups with celebrity designers, and (4) Large inventory at retail outlets are key to gaining market share.
- Our industry/store visits suggest that Tanishq has a headstart in design offerings as its wider geographic presence implies better Karigar tie-ups in the regions targeted for expansion. South is largely a homogenous market in terms of designs offered/purchased and accounts for ~75% of the revenues for major South jewellers. This clearly suggests that south jewellers have some catching up to do on their tie-ups with Karigars ergo, on the design curve. However, we suspect able competitors such as PCJ, Kalyan are closer in the catch-up phase given their relative breadth of presence vs other jewellers (ex-Tanishq). PCJ's in-house manufacturing capabilities is expected to hold the company in good stead as the battle over designs intensifies. Malabar Gold and Joyalukkas too are fast climbing up the design curve.
- **Sourcing of gold could be the joker in the pack:** Jewellers source their raw material through a mix of (1) **Gold on lease through banks, wherein designated bullion banks charge an interest rate of ~2-4%.** This is the cheapest source of funding inventory and gold procurement, (2) The (old) gold exchange route is where consumers exchange their old jewellery for new jewellery (or for cash), (3) Jewellers also purchase gold in the domestic spot market.
- The mix of sourcing gold varies across jewellers. Given that banks have tightened the noose on lending to the industry, we believe jewellers may have to re-look their sourcing strategies and focus on procuring more from their gold exchange schemes.
- An attractive gold exchange scheme helps jewellers to (1) De-risk its sourcing dependence on Gold on lease (2) Up-sell costlier (and more profitable) jewellery to consumers.
- **Exchange schemes can drive SSSG for SUPERPACK:** The up-selling opportunity presented by an attractive gold exchange scheme could help top jewellers stoke up SSSG as typically the consumer ends up spending ~1.4-1.7x the exchange value. Our industry visit suggests that top jewellers typically have ~50-70% of repeat customers who are ideal candidates to push this too. We estimate Titan and PCJ to account for ~5% & ~2% respectively of the total gold exchange market. This could nearly double for both over 5 years Across zones, big-box jewellers have revised their exchange programme (more lucrative for consumers now) to capture the up-selling opportunity.

SUPERPACK's est exchange market share (FY18)



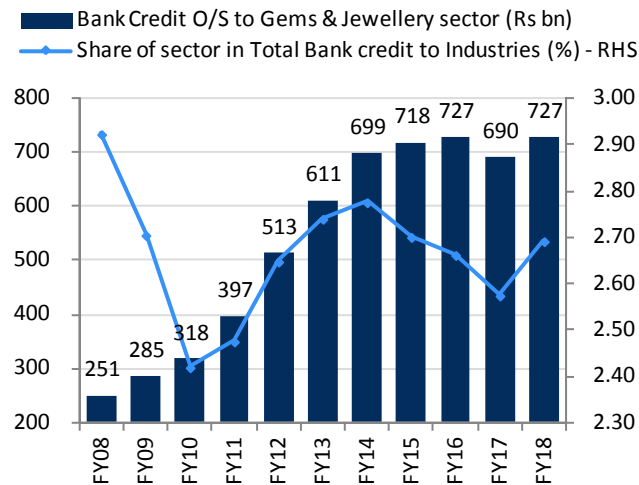
Source: Company, HDFC sec Inst Research

Gold on lease for listed jewellers (FY18)



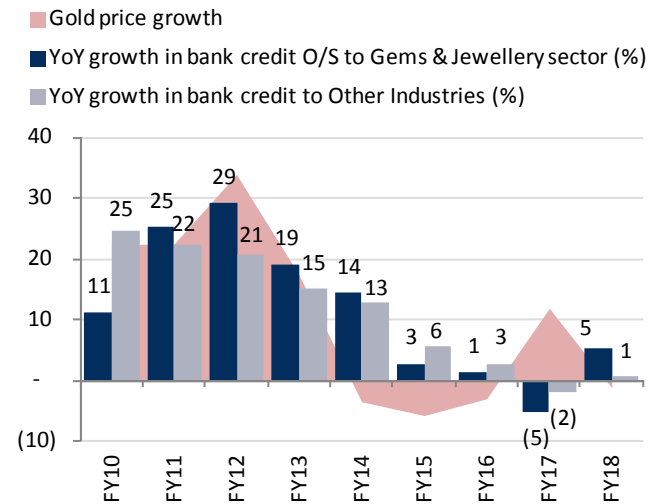
Source: Website, Company, HDFC sec Inst Research

Bank credit sector and share in exposure



Source: Company, HDFC sec Inst Research

...Credit growth tends to mimics gold prices with a lag



Source: Company, HDFC sec Inst Research

Expert talk

Mr. Vijayraghavan

Chief Executive Officer – GRT

- **Biggest Jeweller by revenue:** GRT is one of the biggest and most efficiently managed jewellers in India by revenue. If one clubs the private company along with the two partnerships, the group is estimated to have clocked ~Rs 140bn in revenue from jewellery. It operates across the four southern states of Tamil Nadu, Karnataka, Kerala and AP and operates out of ~46 stores in India. The company is one of the leanest jewellers in India with industry leading stock-turning efficiency.
- **'FY19 will be the year of consolidation'** Mr. Vijayraghavan was of the opinion that FY19 will mark the year of consolidation after a phenomenal FY18 for the industry and for GRT. Highly leveraged jewelers are expected to get down to brass tacks and improve working capital efficiency as banks tighten the noose on credit. GRT's cash conversion efficiency is amongst the highest, albeit it is also a function of the sales mix.
- **Expansion plans:** GRT intends to add ~5 stores/year (via leased stores) down south for the next couple of years. Expansion philosophy is simple – **add stores – monitor performance – bring performance to match up to mature stores within a year – expand again**. Kerala is one market down south which GRT doesn't have a strong presence in and it intends to change that in a couple of years.
- **Focus will be on improving SSSG and studded jewellery for margin expansion:** GRT has managed to deliver a ~7-10% SSSG each year since FY12 and intends to sharpen focus on SSSG even more over the next 2-3 years. This SSSG-led growth coupled with its focus on pushing studded jewellery is what GRT is banking on to improve margins. A typical day at GRT's T Nagar store witnesses ~400 walk-ins, of which only ~12 customers purchase studded jewellery. GRT's focus is to up-sell diamond-studded jewellery to these customers through their activation programmes. It is also focusing on sharpening its quality control process. This is expected to bring in a lot more efficiency in inventory management.
- **On GRT's Brand Equity:** Consumers prefer purchasing gold from GRT as it has been considered auspicious to do so for generations, especially in Tamil Nadu. Given the brand might, efficiency remains best-in-class. GRT turns jewellery faster than most in the trade.



Mr. Baby George**Chief Executive Officer – Joyalukkas India Pvt. Ltd**

- **Joyalukkas' Indian operations** (housed in Joyalukkas India) commenced operations in FY02. The company operates through 78 of its owned/leased stores across India with an employee count of ~4500. Key states of presence are Tamil Nadu, Kerala, Karnataka, Telangana, Gujarat, Maharashtra, AP, Punjab and Delhi
- **Expansion will be the focal point:** Unlike GRT, Mr. George is of the view that it is increasingly difficult to sustain SSSG for any player in the South market as competition is fierce and same store sales may at best be stable going forward. Incremental growth is largely going to come from expansion in north and west. The jeweller intends to add ~20 stores/year and is eyeing Delhi, Haryana, Punjab, and Maharashtra as grounds for expansion. (Confident of touching 100 stores by FY19). Down South, the chain intends to add stores in Hyderabad and Bangalore. A lion's share of growth for Joyalukkas over the last three years has been through network expansion. That being said, Mr. George was the first to appreciate the efficiency of GRT's (competitor) operations down South.
- **Studded jewellery to drive margins:** Despite being a predominant south player, Joyalukkas enjoys one of the best studded ratios among peers within the unlisted space and hence better gross margins. Mr. George too highlighted that studded ratio will be the key margin lever going forward and focus will be to push diamond jewellery.
- **Prioritizing exchange-based sourcing:** Given the up-selling potential, Mr. George was of the view that most big-box jewellers will increasingly source gold through their exchange programme. Also, fresh gold purchases have moderated for the industry given the elevated prices. Joyalukkas too, has tactically managed its sourcing to pull footfalls into stores.

Mr. Sanjay Raghuraman

Chief Operating Officer – Kalyan Jewellers

- **The Thrissur (Kerala) - headquartered Kalyan Jewellers ventured into jewellery retailing in the year 1993. Indian operation houses ~90 stores across India. The chain has a wider geographic spread in terms of revenue and stores vs peers (ex-Titan).**
- **North and west - Focal points for expansion:** Mr. Raghuraman highlighted his focus on north and west for expansion. Key cities targeted for expansion include Mumbai, Delhi, Kolkata, Rajasthan, UP and MP. Kalyan intends to add ~15-20 stores per year.
- **Store size and designs key for gaining BRIDE's mindshare:** The avg. store size for a Kalyan store ranges from 5-8k sq. ft. Mr. Raghuraman highlighted that the jeweler intends to expand via owned stores but will not budge on store sizes inspite of the expansion drive as it remains one of the essentials (apart from designs) to capture the bride's mindshare.
- **Studded jewellery off-take better vs peers:** Kalyan enjoys better studded jewellery off-take given its wider geographic presence vs other south jewellers (estimated at 18-20% - FY17). **'Studded ratio is expected to inch up'** - Mr. Raghuraman quips as Kalyan further penetrates into the north and west.
- **Never shut a single shop:** Kalyan Jewellers typically is known for a big-bang store launch with strong brand ambassadors such as Mr. Amitabh Bachchan endorsing its brand. Hence, break-even point is typically longer for a store. However, Mr. Raghuraman highlighted that till date the jeweller has not shut a single shop in its history.
- **Don't want to deal with franchisee idiosyncrasies:** Management also highlighted that it doesn't feel comfortable dealing with franchisee idiosyncrasies such as loyalty issues, franchisee investment vagaries and hence prefers the owned store route of expansion.



Mr. Sanjeev Bhatia

Chief Financial Officer – PC Jeweller



- PC Jeweller is one of the strongest wedding jewellers in India with an estimated market share of ~4% (~85% of PCJ's domestic sales). While it is present in 20 states; the skew is heavily tilted to the north (~70% stores are in north); the revenue skew towards north is even more pronounced.
- **Focus remains on expansion:** Mr. Bhatia highlighted that *aggressive expansion is the need of the hour as competitors are expected to close in on north for incremental share*. However, given PCJ's expansion plans of 25-30 stores (largely via franchisees) and design capabilities; key vitals of PCJ will remain healthy despite the competition. Cities targeted for expansion are Pune, Aurangabad, Nagpur in the west and Hyderabad, Bangalore and Mangalore down south. *Mr Bhatia also highlighted that it doesn't intend to enter well-entrenched South markets such as Thrissur as profitability levels of the market doesn't justify expansion there. Over 60% of the top-line growth can be expected to come from network expansion.*
- **On track for franchisee tie ups:** PCJ added 5 franchisee stores in FY18 and it is on track of executing its franchisee tie-ups in FY19.
- **Competition will increase as South jewellers eyeing North too:** South jewellers such as Malabar Gold, Joyalukkas and Kalyan are increasing their presence in north, Mr. Bhatia quips, however the opportunity to tap is big enough for everyone to co-exist.
- **Efficiency in biz to increase:** Management is focusing on reducing its exports biz relevance which should improve working capital efficiency and hence return ratios. *Next 2-3 years will be a combination of aggressive expansion and getting more lean and efficient at the same time; said Mr. Bhatia*
- **In-house manufacturing should increase:** Over the next 2-3 years, in-house manufacturing should inch up from current levels which in turn will help PCJ offer a wider assortment of designs to the consumer.
- **To up the frequency of collection launches:** Mr. Bhatia highlighted that in order to gain market share, PCJ is targeting 1. At least one wedding collection per quarter, 2. One light weight jewellery launch every 2 months.

Flagship Store visits

Flagship Store Visits	Joyalukkas	Kalyan	Malabar Gold
Location	T-Nagar	T-Nagar	T-Nagar
Store Size (Sq ft)	~60000	~44,000	~40,000
Avg. Annual Throughput (Volume)	-Gold: 1200 kg, of which ~700kg is exchange -Silver: 1000 kg '-Diamond & other precious stones sales: Rs. 1.1-1.2bn	-Gold: 400kg, of which ~200-250kg is exchange -Silver: 650-700kg/year '-Diamond & other precious stones sales: Rs. 600-750m	-Gold: ~500kg '-Diamond & other precious stones sales: Rs. ~400mn '-Silver: 50-60kgs/day
Making Charges	-Gold & Studded Jewellery: Typically range from 5-30% -Silver Jewellery & Pieces: Rs 6-20 per gram	In Gold: -Chains: 3-13%; Necklaces: 3-25%; Bangles: 3-15%; Rings/Studs/Locketts: 3-18%; Bracelets: 3-18% In Silver: -Gifts: at MRP; Plates/Glasses Rs 2 per gram; Anklets: Rs 2-3 per gram	In Gold: -Plain gold jewellery: 3-12% -Studded Jewellery: Realizations range 58-78k/carat -Ruby-emerged jewellery: 24%
Consumer purchasing behaviour	-Chettinad (necklace) - 30% of gold sales -Antique jewellery & Nagas - 20-25% of sales	-Chains & Bangles: 50-60% of sales -Necklaces: 25% of sales -Rings & Studs: 20% of sales	-Chains: 30 of sales -Bangles: 25% of sales -Necklaces: 30% of sales -Rings, Anklets & Studs: 15% of sales
Avg ticket price	50-60k/customer	Plain Gold Jewellery: 35k/customer Studded Jewellery: 50k/customer	35-45k/customer Avg. ticket wt: 12-15g (Gold)/. This has decreased from 16-20g a 3-4 years ago
Customer conversion rate	-200-250 walk-ins; of which 85-90% conversion rate	-70-80 walk-ins; of which 85-90% conversion rate	-120-200 walk-ins; of which ~75-80% conversion rate
No. of Employees	~200 salespeople; avg. emp. Cost 20k/month	~130 salespeople; Avg. emp. cost: Rs 20k/month	~100+ salespeople
Other stores in Chennai	Chrompet (~2500 sq ft) -Velachary (~2800 sq ft) Plans to open 1 store in Anna Nagar	Adayar, Chrompet, Velachary	Chrompet

Source: Company, HDFC sec Inst Research

Flagship Store Visits	GRT	Thangamayil	
Location	T-Nagar	Madurai	Coimbatore
Store Size (Sq ft)	~44,000	~5700	~5740
Avg. Annual Throughput (Volume)	Flagship does over Rs 10bn in revenues. Gold: 91%, Diamond: 3%, Silver: 5%, Others: 1%	-Revenue: Rs 2.4bn -Gold revenue: Rs 2.2bn -Silver & Diamond revenue: Rs 0.2bn	-Revenue: ~Rs 900mn -Gold revenue: ~Rs 840mn -Silver & Diamond revenue: ~Rs 60mn
Making Charges	In Gold: -Chains: 3-13%; Necklaces: 3-25%; Bangles: 3-15%; Rings/Studs/Lockets: 3-18%; Bracelets: 3-18% In Silver: -Gifts: at MRP; Plates/Glasses Rs. 2 per gram; Anklets: Rs. 2-3 per gram	In Gold: -Chains: 3-13%; Necklaces: 3-25%; Bangles: 3-15%; Rings/Studs/Lockets: 3-18%; Bracelets: 3-18% In Silver: -Gifts: at MRP; Plates/Glasses Rs. 2 per gram; Anklets: Rs. 2-3 per gram	In Gold: -Chains: 3-13%; Necklaces: 3-25%; Bangles: 3-15%; Rings/Studs/Lockets: 3-18%; Bracelets: 3-18% In Silver: -Gifts: at MRP; Plates/Glasses Rs. 2 per gram; Anklets: Rs. 2-3 per gram
Consumer purchasing behaviour	Not available		
Avg ticket price	~40k/customer	Gold and Jewellery: 10-14 grams/customer Silver, Silver Golusu and Articles: 55-65 grams/customer Silver Articles: Rs. 500-1500/customer	Gold and Jewellery: 10-14 grams/customer Silver, Silver Golusu and Articles: 55-65 grams/customer Silver Articles: Rs. 500-1500/customer
Customer conversion rate	-400-500 walk-ins; of which 90% conversion rate	Conversion ratio is ~80% of all walk-ins	Conversion ratio is ~80% of all walk-ins
No. of Employees	Not available	Not available	Not available
Other stores in Chennai	Has 16 stores in Chennai, Key stores include T-Nagar, Anna Nagar, Purasaivakkam, Tambaram, Old Washermenpet, Adyar, Velachery, Poonamalle	Annanagar, Coimbatore (amongst the bigger stores)	Madurai, Annanagar, (amongst the bigger stores)

Source: Company, HDFC sec Inst Research

KPIs : How do top jewellers stack up?

- South jewellers enjoy higher revenues/sq. ft:** As the table below depicts, South-based jewellers enjoy higher revenue/sq. ft given (1) Higher share of gold jewellery which turns faster vs. studded jewellery, (2) South jewellers' predeominant owned stores (Typically, franchisee revenue/sq. ft is lower, given limited inventory pile).
- While all jewellers have seen their revenue/sq. ft dip with regulatory hurdles over FY14-16, it merits mention that Tanishq, GRT and PCJ did better than the rest. PN Gadgil's SSSG is yet to catch-up with its aggressive store expansion drive (47% CAGR in space addition over FY12-18).

South jewellers enjoy higher revenue per sq ft

Revenue per sq ft (Rs)	FY13	FY14	FY15	FY16	FY17	FY18	5-yr CAGR
Tanishq	131,975	119,805	115,885	96,604	110,678	122,778	-1.4%
PC Jeweller	181,562	168,151	144,879	145,493	137,960	161,886	-2.3%
Thangamayil	328,973	210,017	250,558	220,693	225,507	237,711	-6.3%
TBZ	201,333	207,093	212,549	168,511	155,120	158,261	-4.7%
PN Gadgil			278,473	294,012	230,027	182,858	-13.1%
GRT			417,950	367,960	349,956	379,679	-3.2%
Joyalukkas						326,802	
Kalyan Jewellers						148,854	

Source: RoC, Company, HDFC sec Inst Research. Note: Estimates are used for unlisted players

- PCJ leads the SUPERPACK in profitability:** Given the variances in expansion routes across jewellers, revenue/sq ft may not be comparable. EBIT/sq. ft may be a better metric. PCJ leads here, as ~three-fourths of its revenue comes from the North region which is typically a higher margin market. Also we suspect PCJ's higher in-house manufacturing vs industry bellwether Titan is adding to its profitability. However, with PCJ's thrust on expansion (guidance ~25-30 store additions in FY19, 75% through the franchisee route), we believe EBIT/sq ft will taper down over FY18-23E.

SUPERPACK's profitability per square foot

EBIT per sq ft (Rs)	FY13	FY14	FY15	FY16	FY17	FY18	CAGR
Tanishq	13,394	11,788	11,499	8,861	10,424	13,546	0.2%
PC Jeweller	-	18,258	19,866	17,485	16,826	20,471	2.9%
Thangamayil	16,906	1,608	(954)	6,088	6,770	8,820	-12.2%
TBZ	17,052	14,036	7,162	2,706	5,403	5,935	-19.0%
PN Gadgil	12,643	12,471	14,693	13,078	13,764	10,544	-3.6%
GRT			14,628	13,247	12,948	14,428	-0.5%
Malabar Gold						15,452	
Joyalukkas						15,581	
Kalyan Jewellers						5,832	

Source: RoC, Company, HDFC sec Inst Research. Note: Estimates are used for unlisted players

Titan leads the SUPERPACK in return profile; Thangamayil is on its road to recovery with improving RoEs

PCJ's depressed return ratios is a function of receivable-heavy exports

GRT remains one of the most efficiently managed regional juggernauts, with a return profile bettered only by industry bellwether Titan

SUPERPACK's return profile

	FY13	FY14	FY15	FY16	FY17	FY18
RoE (%)						
Titan	42.3	32.7	27.8	19.7	20.7	24.0
PC Jeweller	29.9	23.2	20.6	18.1	14.6	14.8
Thangamayil	18.9	(7.8)	(15.8)	7.9	9.7	14.4
TBZ	29.6	12.8	3.3	(6.1)	2.9	4.6
GRT			25.1	21.4	20.8	19.9
Joyalukkas				12.4	15.3	20.2
Kalyan Jewellers				1.9	5.4	3.2
PN Gadgil	68.7	79.9	83.7	48.6	47.7	47.8
RoCE (%)						
Titan	27.6	20.4	19.5	14.3	13.5	16.4
PC Jeweller	14.9	12.8	12.6	11.7	10.1	9.7
Thangamayil	11.0	1.7	(0.6)	7.7	7.8	7.6
TBZ	16.7	8.7	4.2	2.9	6.2	4.4
Joyalukkas				9.1	11.1	14.6
Kalyan Jewellers				21.7	6.2	4.2
PN Gadgil	14.3	18.3	21.5	18.0	18.8	16.6
RoIC (%)						
Titan	40.3	24.5	20.8	13.6	14.2	17.8
PC Jeweller	16.7	14.1	12.8	11.7	10.2	10.8
Thangamayil	11.2	1.1	(0.9)	7.3	7.9	7.9
TBZ	16.7	8.8	3.9	2.6	6.1	4.2
Joyalukkas				8.6	10.6	13.1
Kalyan Jewellers				8.9	6.0	4.4
PN Gadgil	14.2	22.0	27.7	20.5	20.4	17.5

Source: RoC, Company, HDFC sec Inst Research

PN Gadgil & Sons and Thangamayil have the fastest turning inventory. This is because over ~92-93% of their sales is plain gold jewellery which typically turns faster

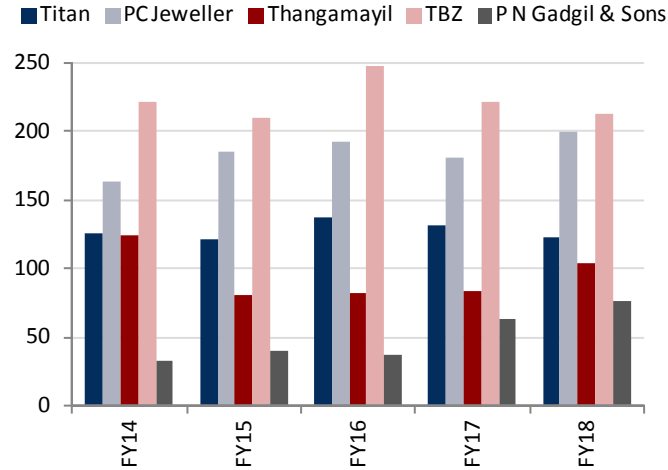
Despite best-in-class studded ratio (~30%), industry bellwether Titan is one of the most efficient in inventory management

As 90% of PCJ stores are owned inventory sits in their books and hence no of days are higher for PCJ.

Exports biz keeps receivable days high too for PCJ

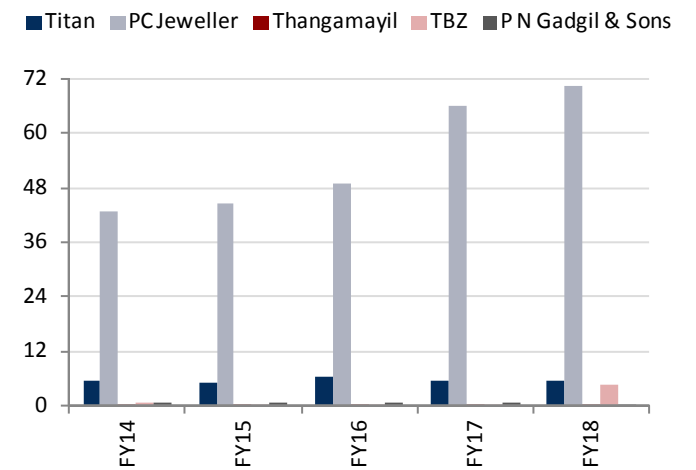
Overall, Titan has one of the shortest cash conversion cycles despite a meaningful presence in slow-moving studded jewellery

Player-wise inventory days



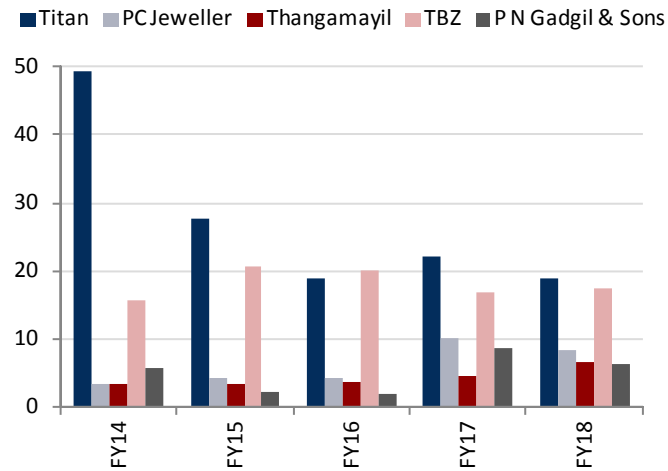
Source: Company, HDFC sec Inst Research

Player-wise receivable days



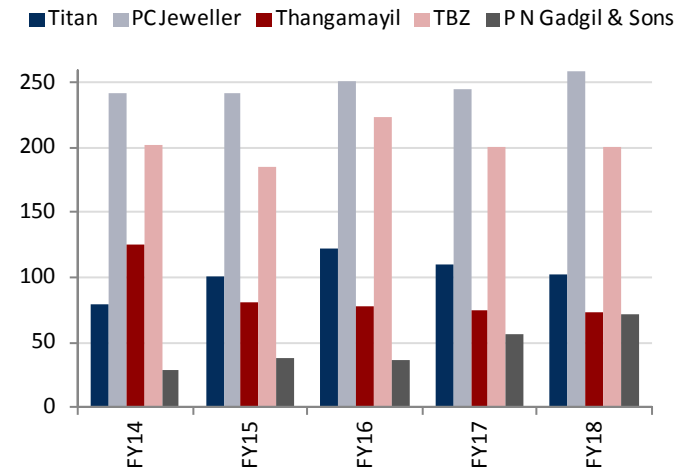
Source: Company, HDFC sec Inst Research

Player-wise payable days



Source: Company, HDFC sec Inst Research

Player-wise cash conversion cycle (days)



Source: Company, HDFC sec Inst Research

-21,778 BIS-listed stores in India; Chain stores comprise only one-fourth in the universe

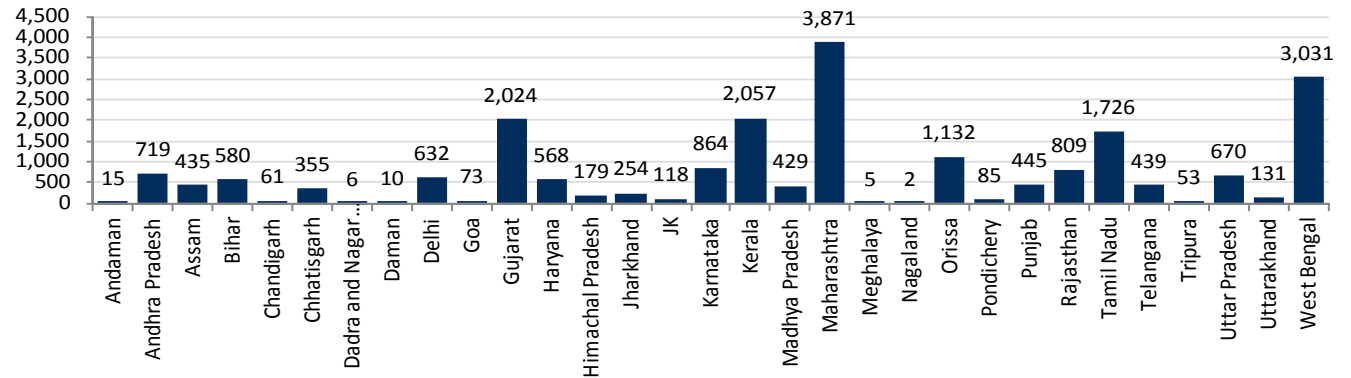
-Maharashtra leads the pack of BIS-listed stores. North Zone (Mah, Guj, MP and Goa) enjoy 31% store share followed closely by the South pack (TN, Karnataka, AP, Kerala, Telangana) at 27% store share given the higher level of awareness towards quality/purity amongst customers

Top 15 states contribute ~90% of the BIS listed stores and contribute ~86% of India's GDP

Where could the expansion come from?

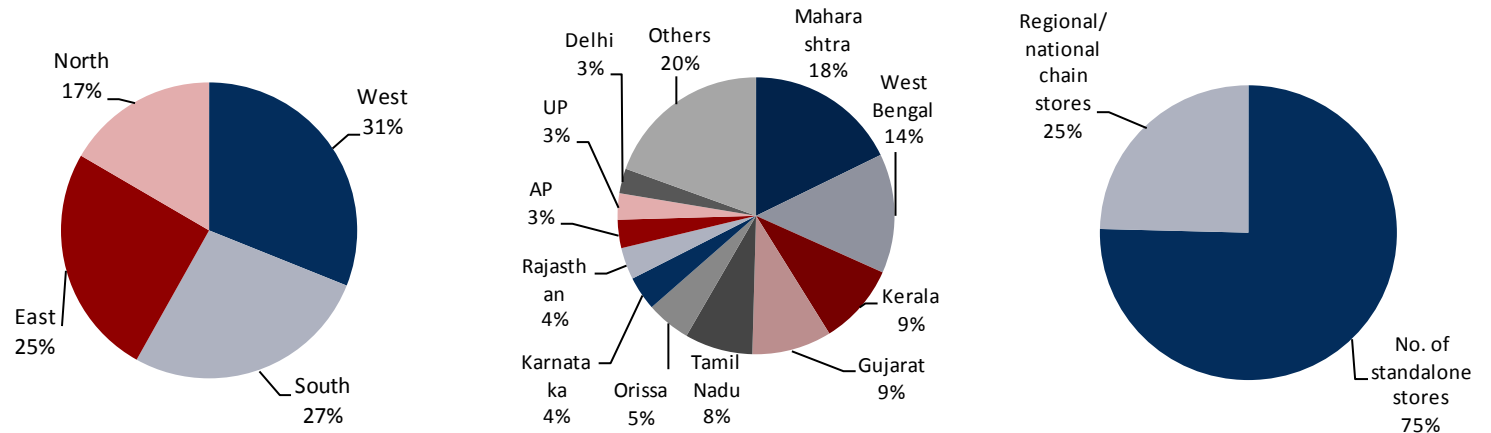
- Our universe of 21,778 stores comprises jewellers who have been granted a license from BIS (Gol's sole agency in India for Hallmarking and Assaying of Gold). BIS ensures conformance to Gold quality/purity standards by its listed jewellers.
- BIS-listed jewellers cover ~553 districts out of the 700+ districts in India. We have further cut the data to districts in states where (1) Per Capita Income >= National Per Capita Income, (2) Districts with a minimum of 20 stores. Despite using the second cut above and restricting our consideration set to 216 districts, the addressable opportunity for expansion for the SUPERPACK still remains significantly large.

State-wise BIS listed jewellery stores in India



Source: BIS, HDFC sec Inst Research

South leads in chain stores, which account for ~1/4th of the universe



Source: BIS, HDFC sec Inst Research

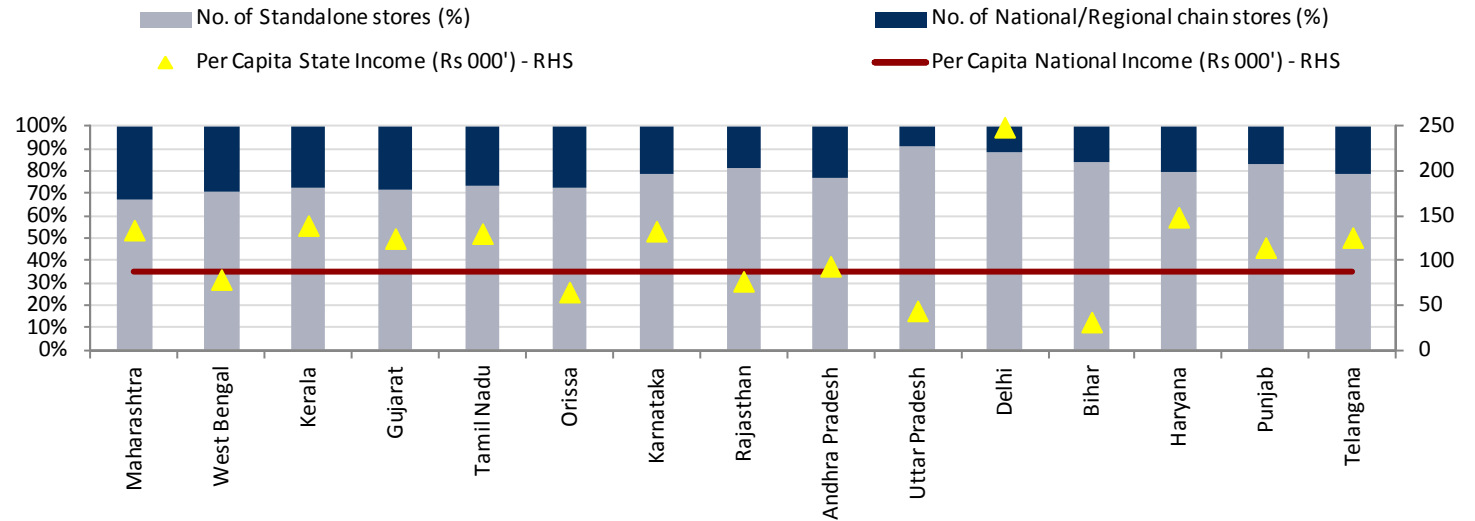
South remains a closely-fought; predominately plain gold jewellery market. (est: ~Rs. 120-130bn). While top jewellery chains in South only have ~7% stores share; they command nearly 40% revenue market share.

TN remains the largest market down South (est. at ~Rs. 620-630bn). Almost all major jewellery chains have a home in TN. Hence, extremely competitive.

Realization gap between standalone & chain jewellers is low vs India avg.

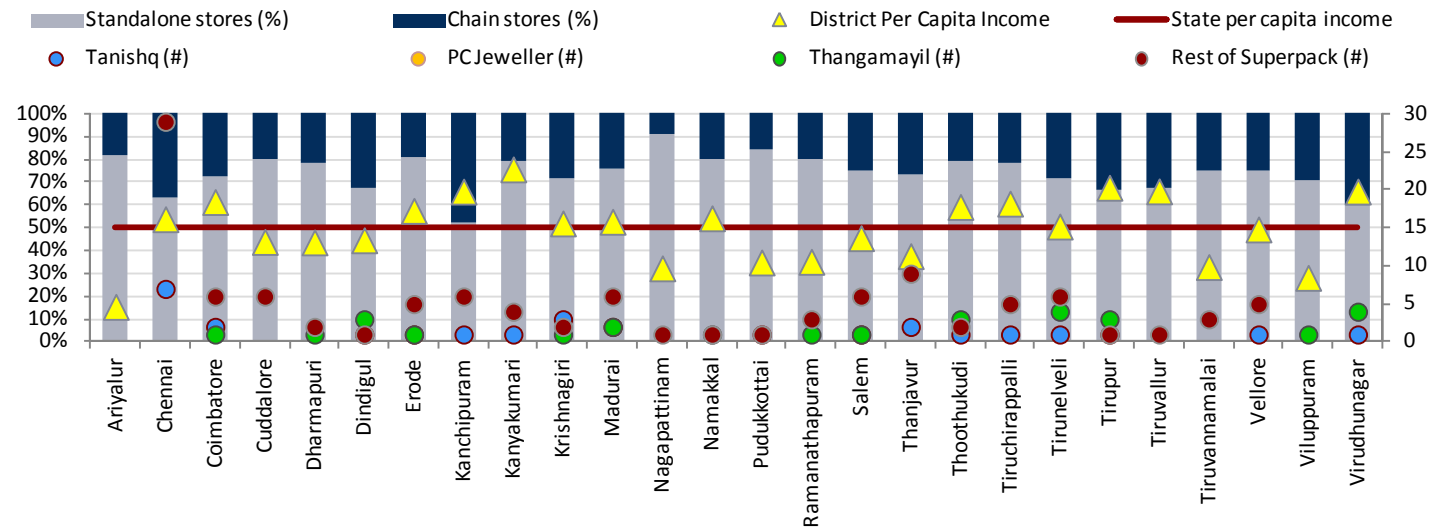
Coimbatore, Cuddalore, Erode Kanyakumari, Krishnagiri, Madurai, Namakkal, Ramanathapuram, Thoothukudi, Tiruchirappalli, Tiruvallur, Vellore are fertile grounds for expansion as store share of Top Jewellers remains low

State-wise BIS listed jewellery stores in India



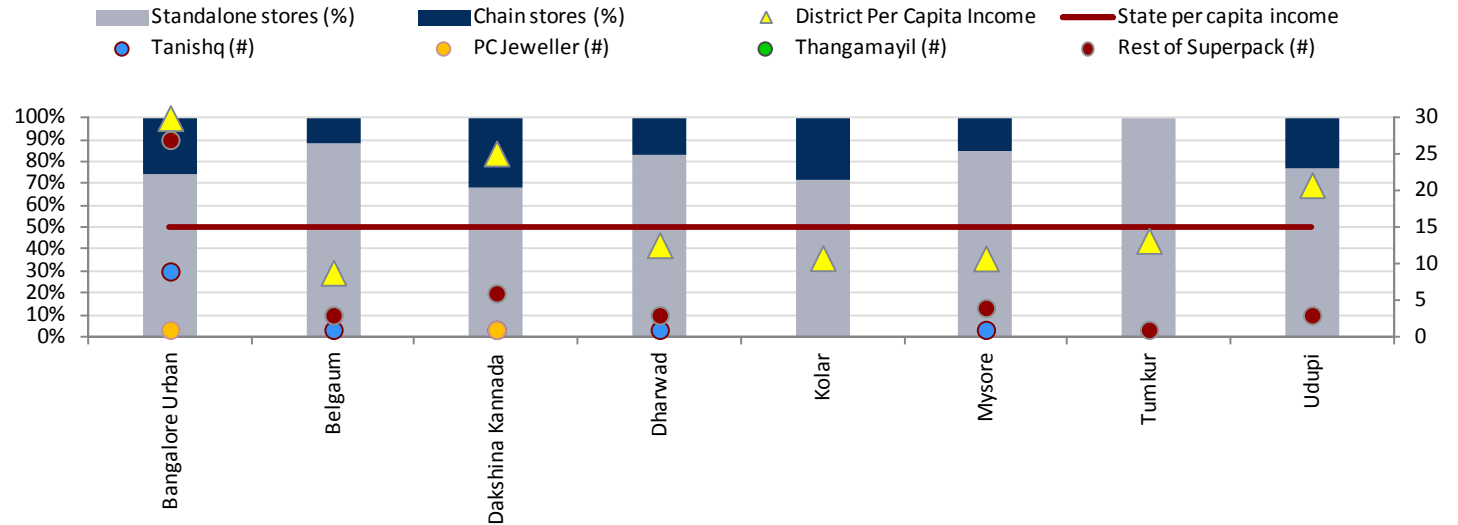
Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Tamil Nadu



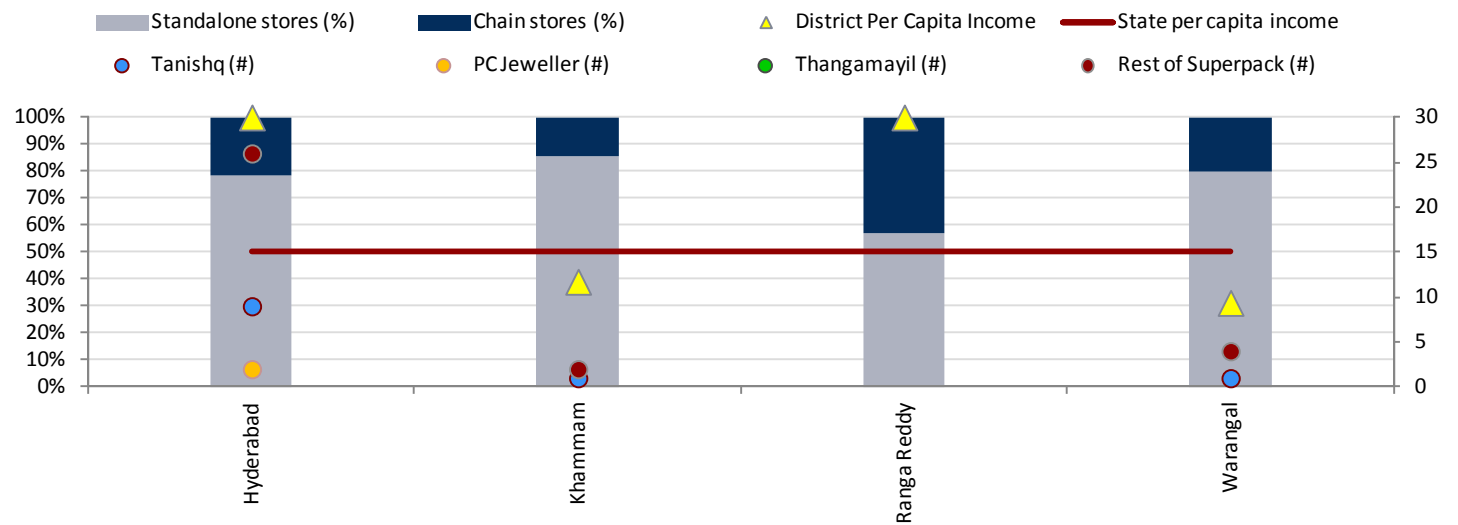
Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Karnataka



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Telangana



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

SUPERPACK has <= 10% store share in Dakshina Kannada, Dharwad, Kolar, Mysore, Tumkur, Udupi

Bangalore seems well-populated with store chains.

In Telangana, Ranga Reddy is one district to tap wherein the SUPERPACK doesn't have a presence.

North & West are key markets in terms of size and profitability as consumers are more open for higher margin studded jewellery.

Market is characterized with more impulse purchases vs a more planned jewellery/gold accumulation approach down South

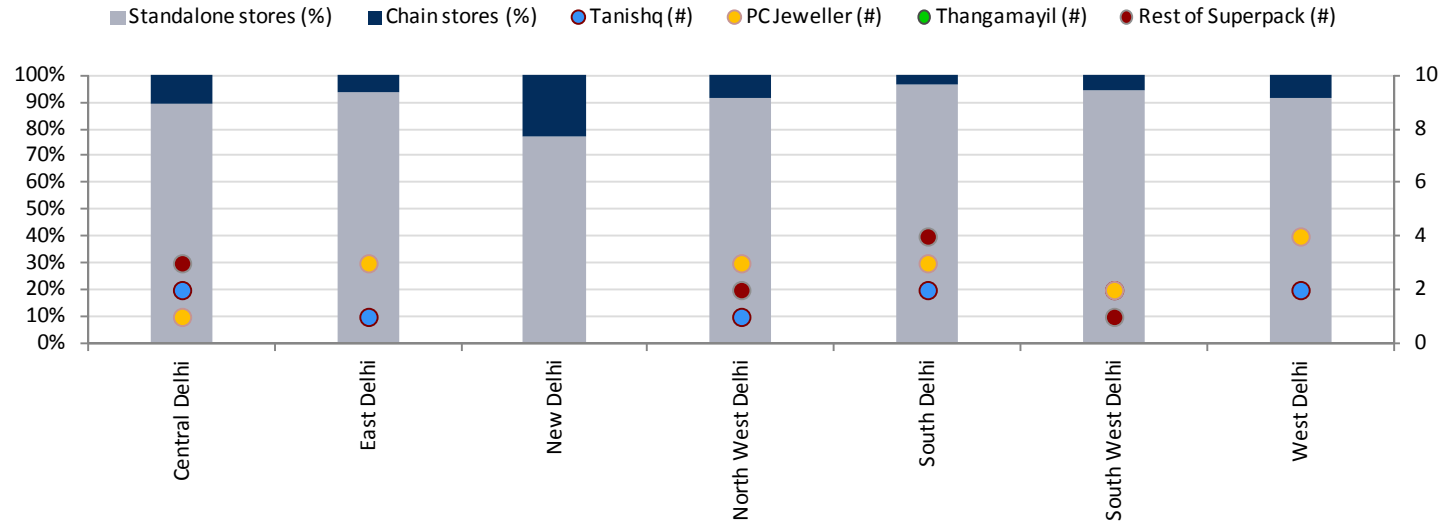
Both regions combined are fairly indexed (accounts for 48% of the store share and ~46% of domestic industry revenue).

Most districts in Delhi are districts wherein SUPERPACK has a 3-8% store share.

Tanishq could strengthen its presence especially in East & North west Delhi

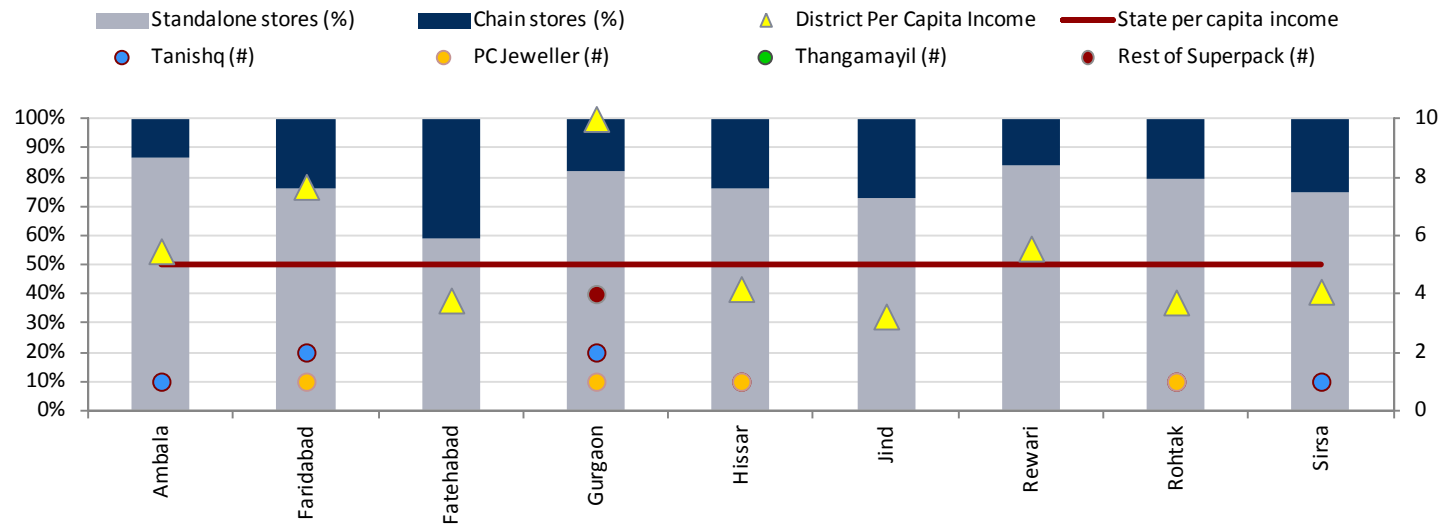
Haryana remains largely untapped by the SUPERPACK (~3% store share). Ambala, Faridabad, Fatehabad, Hissar, Rewari, Rohtak & Sirsa offer high expansion potential

Delhi



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Haryana



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

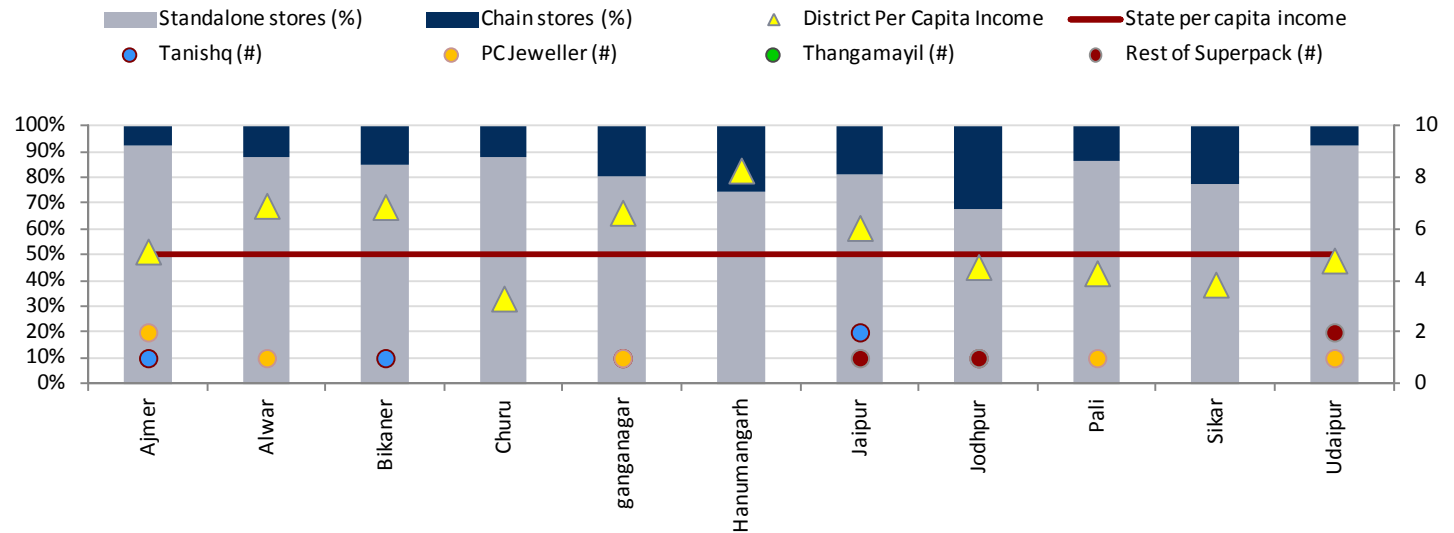
Ditto for Rajasthan. Ex-Ajmer & Udaipur almost all districts are fertile grounds for store expansion for top jewellers.

This is one state where profitability could be higher as bejeweled jewellery is extremely popular in Rajasthan.

Tanishq, PCJ, Kalyan have only 2/1/1 stores each in Jaipur and 1 each in Jodhpur of the ~270 BIS-listed jewellers in the 2 districts. Kalyan & Joyalukkas too have narrowed down Rajasthan as a key area for expansion

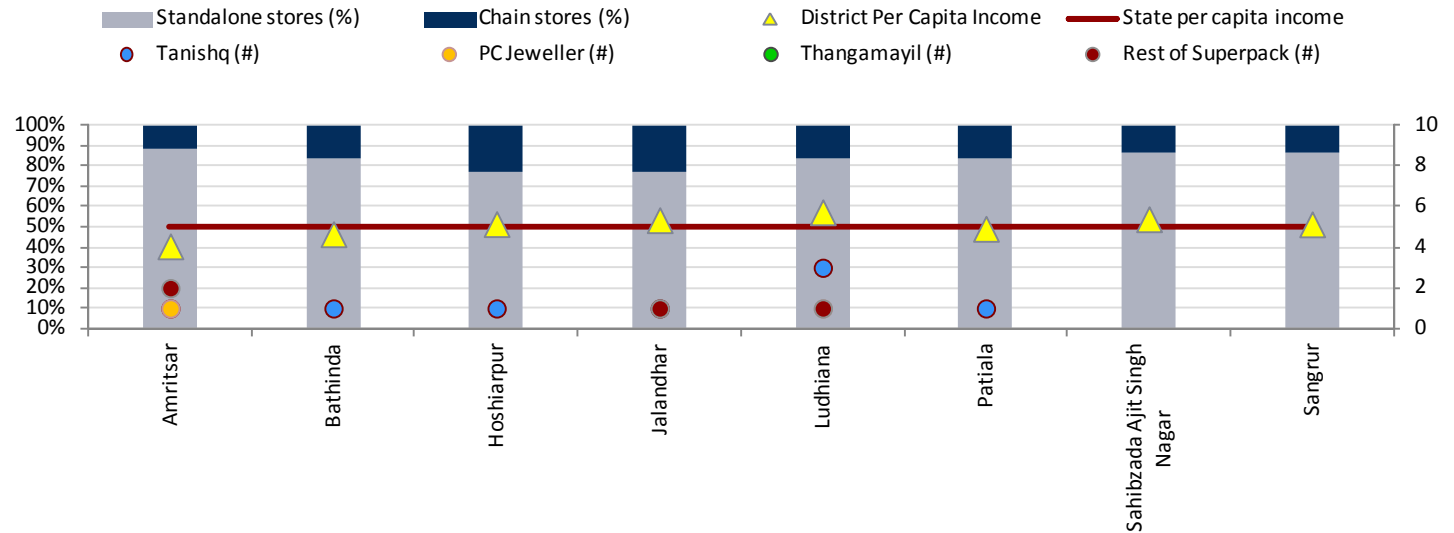
Ex-Amritsar all districts are fertile grounds for store expansion for the SUPERPACK

Rajasthan



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Punjab



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Maharashtra is relatively well penetrated by the SUPERPACK. However there are pockets which still offer a potential to expand.

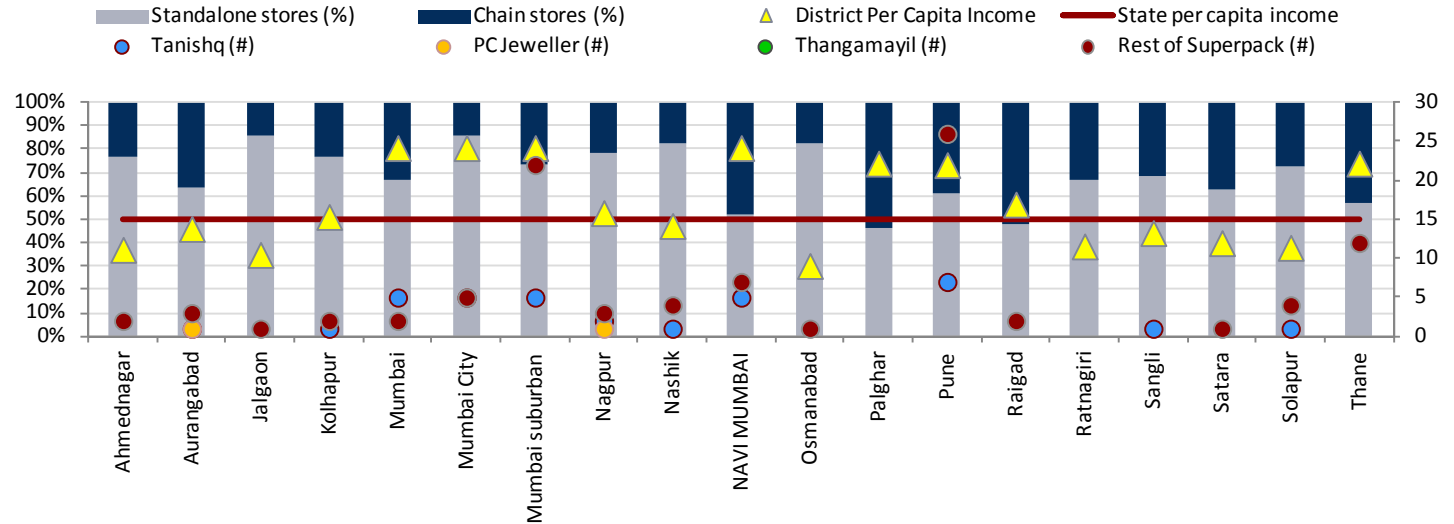
Navi Mumbai, Pune & Aurangabad districts are highly penetrated by top jewellers (57%, 39% & 17% store share respectively).

However, there are nearby catchments which may offer significant potential to expand. PN Gadgil is a classic case in point. Being one of the larger Maharashtra-based regional players, it intends to add 15 stores in Shirdi, Phaltan, Badlapur and Pune suburbs over FY18-20.

Of the 19 districts Maharashtra has (with > 20 stores/district), 16 districts have a miniscule store presence of the SUPERPACK. (ranging from 0%-7%)

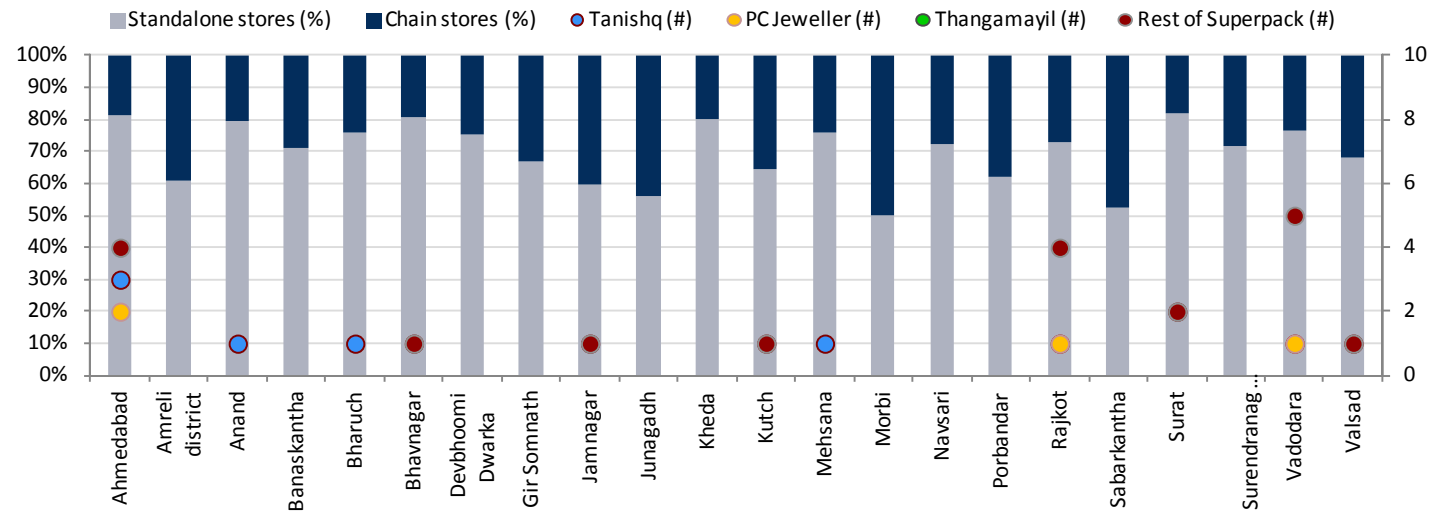
Gujarat has 22 districts (with >20 stores). Ex-Rajkot, Surat and Vadodara, SUPERPACK has an extremely low store presence (0-4% store share). These districts are apt for further penetration

Maharashtra



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Gujarat



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Along with the Southern states & Maharashtra, Gujarat accounts for a sizeable chunk of NRIs who purchase gold jewellery during their stay in India. NRI purchases are estimated at 10-20% of sales in Guj (WGC).

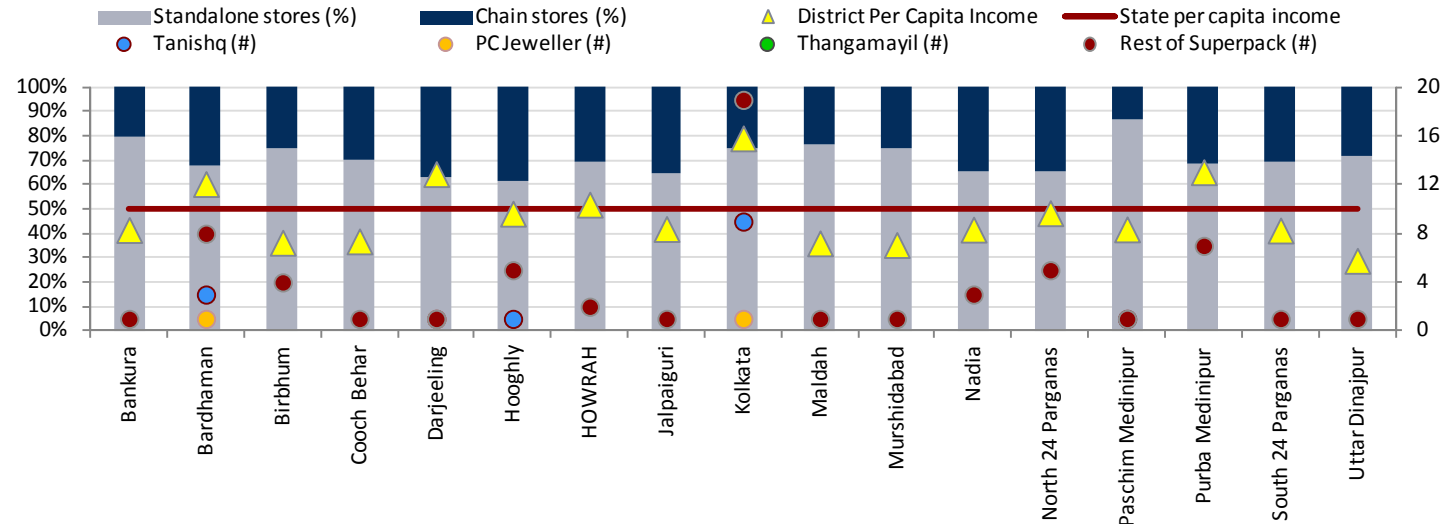
West Bengal remains a predominantly 22k plain gold jewellery market. Avg ticket volumes/marriage for upper-middle class is ~300g and is higher vs India Avg.

Kolkata is a key market. Tanishq and Senco are well represented with 9 and 13 stores respectively. PCJ, Joyalukkas, Kalyan, Malabar Gold may want to rev up expansion in Kolkata to catch-up on presence.

Ex-Birbhum, the SUPERPACK is highly under-represented in West Bengal. SUPERPACK's share across districts is ~0-4%

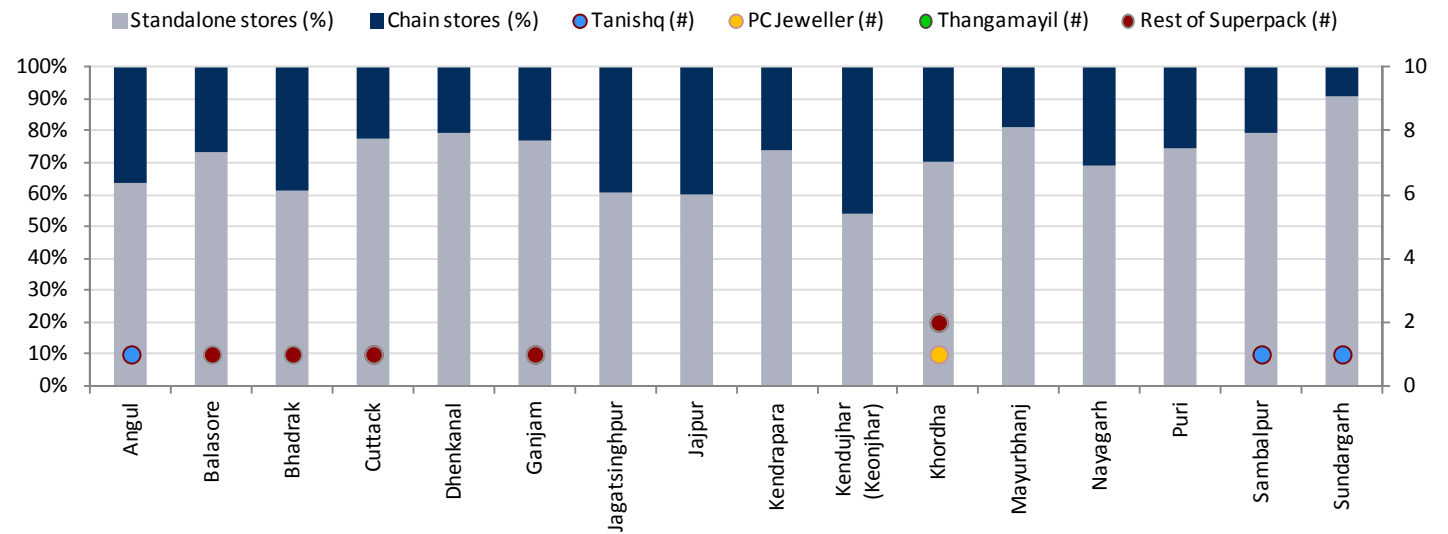
Orissa remains highly-underpenetrated by the SUPERPACK. (Store share ranging from 0-4% across all 16 districts with >= 20 stores.

West Bengal



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

Orissa



Source: BIS, Department of Economics & Statistics, HDFC sec Inst Research

INDUSTRY JEWELLERY RETAIL
CMP (as on 20 Jun 2018) Rs 896
Target Price Rs 820

Nifty 10,772

Sensex 35,547

KEY STOCK DATA

Bloomberg TTAN IN

No. of Shares (mn) 888

MCap (Rs bn) / (\$ mn) 789/11,577

6m avg traded value (Rs mn) 2,268

STOCK PERFORMANCE (%)
52 Week high / low Rs 1,006/501

	3M	6M	12M
Absolute (%)	1.9	2.9	68.7
Relative (%)	(5.8)	(2.3)	55.1

SHAREHOLDING PATTERN (%)

Promoters 52.91

FIs & Local MFs 6.10

FPIs 20.72

Public & Others 20.27

Source : BSE

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Best in class, but no See's Candy

Over the past decade, industry bellwether Titan has accumulated ~Rs 85.6bn in pre-tax earnings. However, the company has had to inject ~Rs 60.4bn to its invested capital (~10x FY08 exit level). Hence, while it is the best franchise in trade with (1) A strong brand recall, (2) Track record of consistent growth, (3) Best-in-class management, it is clearly no See's Candy as the industry works on a 'put-up-more-to-earn-more' business model.

We expect Titan to scrape through its targeted 20% jewellery revenue CAGR over FY18-23E, underpinned by the sheer opportunity in the wedding and HVD space. However, Phase 2 (post FY21) will be closely fought as able contenders catch up on capital and design. Consequently, we expect RoCE (restated) to improve (~190bps) and nearly peak out by FY21E at ~18%.

We initiate coverage on Titan with a Neutral recommendation and a DCF-based TP of Rs 820/sh implying a P/E of 42x FY20 earnings (~20% premium vs avg 5-yr two-year forward P/E). The premium seems justified given the growth visibility in Phase 1 (FY18-21E). Note our FY19/FY20 earnings estimates are ~5/9% lower than consensus.

Investment rationale

- Phase 1 – Advantage Titan; Phase 2 – Battle is on: Titan's decadal track record of compounding revenue/earnings at a CAGR of 18/22% remains unmatched. We have divided Titan's next decade into two phases – Phase 1 (FY18-21) & Phase 2 (FY21-28E). Given the capital and design arbitrage Titan enjoys vs peers, we expect Titan to milk the growth opportunity through both 1. Expansion, 2. SSSG over

Phase 1. Expect Titan to nearly double its market share from an estimated 4.2% to ~8.1% of the market by FY23. Phase 2 is expected to be closely fought as able peers catch up on both - capital and designs .

- Operating levers crucial to sustain return profile: Titan's aggression in the lower-margin wedding space (~2% share/25% of jewellery sales) is expected to keep gross margins in check (partly cushioned by impetus on high-value diamond sales). Given that both segments need a wider assortment of designs, pulling operating levers becomes increasingly crucial to off-set working capital deterioration, if any, led by wedding and HVD inventory pile up in order to sustain RoCEs. While we expect Titan to pull this off in Phase 1 given the head-start vs peers (190bps RoCE expansion factored over FY18-21E), treading the margin-efficiency equation cautiously will only get tougher post FY21E as peers catch up on their shortcomings.

Financial Summary

YE Mar (Rs mn)	FY18	FY19E	FY20E	FY21E
Net Sales	161,198	198,467	236,412	279,992
EBITDA	16,447	21,161	26,153	31,814
APAT	11,186	14,136	17,218	20,625
Dil. EPS (Rs/sh)	12.6	15.9	19.4	23.2
P/E (x)	71.2	56.3	46.3	38.6
ROE (%)	24.0	25.2	25.7	25.9
RoIC (%)	17.8	19.3	19.7	19.8
ROCE (%)	16.4	18.1	18.3	18.3

Source: Company, HDFC sec Inst Research

- **Exchange programme could help:** Over FY16-18, Titan has increasingly leveraged its exchange programme to source gold. (FY18: 40% of sales vs FY16: 20%). This has helped Titan in 1. Improving its working capital efficiency given the up-selling opportunity (read SSSG) in such a transaction, 2. de-risking its gold sourcing needs. It further intends to increase exchange-based gold sourcing to ~50% of sales by FY23. Thus, higher sourcing from exchange programme coupled with improving franchisee throughput is what we believe will be balancing levers largely offsetting the wedding and HVD-led inventory pile up. We expect RoCE's to improve by ~190bps to 18.4% by FY20. **(Note: Our definition for computing RoCEs differs from the street).**
- **Category attraction issues persist in non-jewellery:** Non-jewellery continues to face category attraction issues and is fraught with disruptive offers. This is evident in the weak FY13-17 performance and declining profitability. (FY18 marked a recovery). While Titan has put its best foot forward to correct

these issues, we remain cautiously optimistic on the non-jewellery biz and build in a conservative 9% revenue CAGR over FY18-21E.

- **Tailwinds baked in; valuation keep us at bay - NEUTRAL:** Our 20-year DCF bakes in all tailwinds in Phase 1 on the back of which Titan is expected to scrape through its 20% revenue CAGR aspiration over FY18-23 in jewellery. **Where we differ is Phase 2,** wherein we expect major jewellers to catch up on-capital, expansion and designs. (~14% jewellery sales CAGR expected for Titan). CMP suggests that Titan continues its scorching growth rate in jewellery over Phase 2 (FY21-29E) too; which in our view, even for a brand like Titan is a stretch. Our DCF-based TP of Rs 820/sh; implies a P/E of 42x FY20 earnings (a 20% premium to Titan's 5-yr avg. two year forward P/E of 35x). **The want from 'growth' is massive to justify current valuations, given Titan's RoIC of ~18%. (Gold on lease and gold scheme sales treated as debt). Note: Our FY19/FY20 earnings estimates are 5/9% below consensus.**

Titan: Our Estimate vs Consensus

(Rs mn)	HDFC Sec			Consensus			Variance (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	198,467	236,412	279,992	193,022	232,869	277,728	2.8	1.5	0.8
EBITDA	21,161	26,153	31,814	20,840	26,117	32,384	1.5	0.1	(1.8)
EBIT	19,418	23,930	29,056	20,411	26,269	-	(4.9)	(8.9)	-
APAT	14,136	17,218	20,625	14,697	18,699	20,626	(3.8)	(7.9)	(0.0)
Adj. EPS (Rs)	15.9	19.4	23.2	16.7	21.2	23.2	(4.8)	(8.6)	0.1

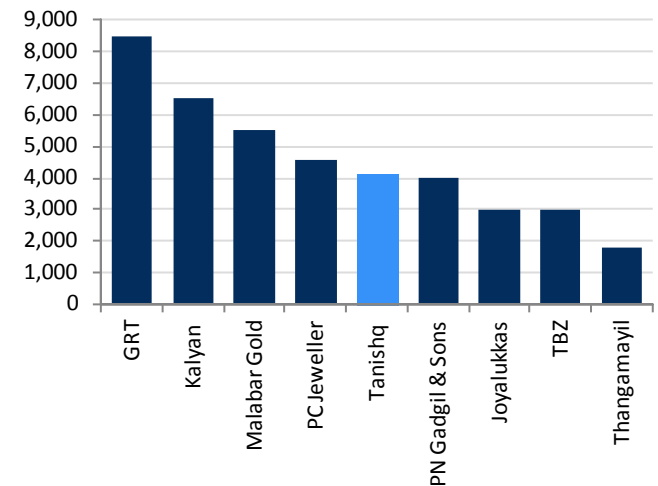
Source: Company, Bloomberg, HDFC sec Inst Research

Phase 1 – Advantage Titan; Phase 2 will be closely fought:

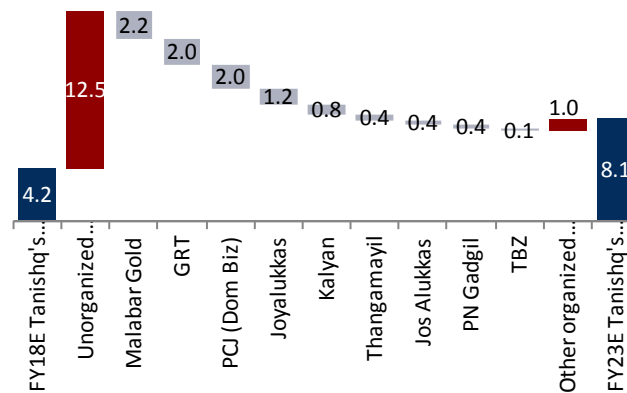
- Titan is expected to nearly double market share by FY23E to ~8.1% underpinned by a confluence of factors: 1. Share gain in Wedding & HVD segment, 2. Head-start in expansion given capital and design shortcomings of peers, 3. Boost to SSSG from exchange and gold scheme programmes.
- Phase 2 (FY21-29E) will be closely fought as peers catch up on capital and design.
- Expect Titan to deliver on the wedding front: Titan seems to be piecing the wedding puzzle well so far. This segment is estimated to have grown by ~35-40% over the last couple of years for Titan, albeit on a small base. We suspect this may have been possible given 1. It now caters to 18 linguistic communities in India, the highest amongst jewellers 2. Has a separate section for wedding collections in key stores, 3. Our store visits also suggested a wider spread of designs vs peers. 4. Recent revision in the exchange program is also expected to perk up wedding output.

- Store size - Only stumbling block: The only stumbling block in our view is Titan’s smaller avg store size (~4000 sq. ft vs 6000-8000sq ft for a typical wedding jeweller). This may limit Titan’s ability of showcasing a wider spread of designs at one go. This is important because for wedding purchases, consumers typically prefer to shop at a store with a wider assortment of jewellery pieces.

FY18 Key wedding jewellers’ avg store size



Titan to nearly double it’s share by FY23E

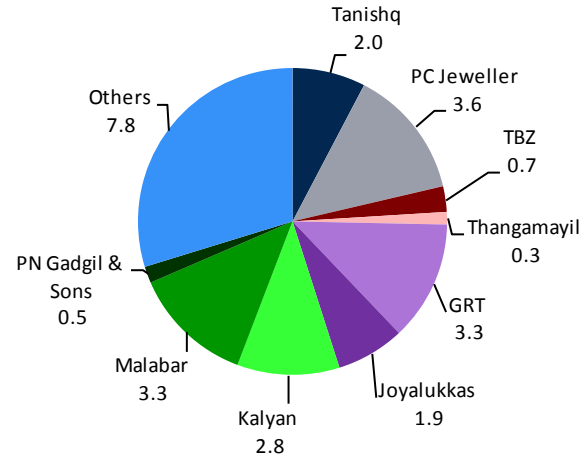


Source: HDFC sec Inst Research

Source: HDFC sec Inst Research (estimates for unlisted players)

- Expect doubling of wedding market share by FY21E: Notwithstanding the store size issue, increasing awareness amongst consumers about under-caratage by unorganized jewellers and the sheer headroom to grow in the wedding market (**SUPERPACK is estimated to account for only 26% of the wedding market**) should help Titan see through its wedding target of 50% of gold revenue by FY23 (vs currently: 35%). We expect Titan’s wedding segment to grow at ~30% CAGR, implying nearly doubling its share in the wedding market to ~4% over FY18-21E.

FY18 Estimated SUPERPACK’s wedding share (%)



Source: HDFC sec Inst Research

- Premium vs peers could reduce as wedding thrust increases:** Given that the wedding segment is extremely competitive and fraught with consumer discounts, we expect Titan’s pricing premium to reduce over peers with time. [\(Link to table 1\)](#) ; [\(Link to table 2\)](#)

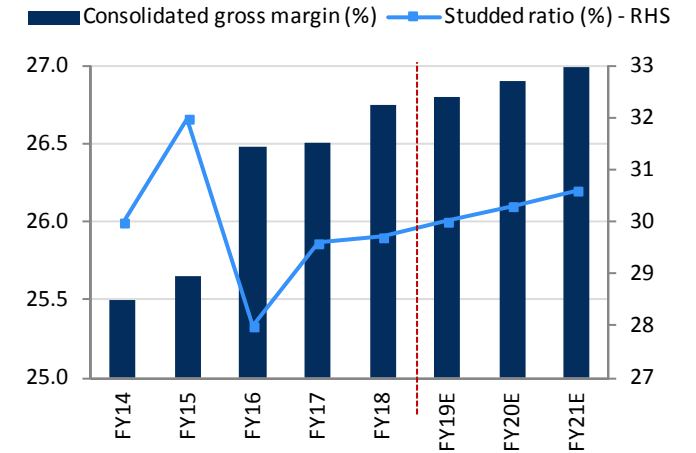
Tanishq’s Padmavat collection:



Source: Company, HDFC sec Inst Research

- Studded ratio to marginally inch up:** We remain upbeat on the growth in studded jewellery (expect 23% CAGR over FY18-21) and expect growth to be largely realization-led given Titan’s focus on increasing its high-value diamond share in the portfolio.

FY18 Gross margins and studded ratio to remain stable



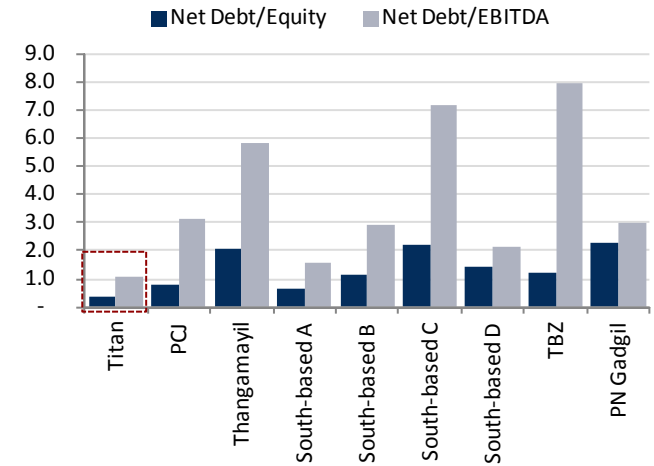
Source: Company, HDFC sec Inst Research

- Peers to play catch-up in Phase 1; Phase 2 will be well contested:** Current unencumbered cash levels and leverage on books warrant a capital infusion for some of the unlisted big-box jewellers if they have to make any meaningful market share gains in the north and west. Also given the predominant south presence of some of these jewellers (South market accounts for ~75% of their top-line), peers will have to catch-up on the design curve vs Titan. This gives Titan an easy 1-2 year headstart on its expansion drive as peers catch up on both – Capital (to expand) and designs. That being said, Phase 2 is expected to be evenly contested as the above arbitrages dwindle over time.

Note: There are some extremely efficiently managed unlisted companies such as GRT which have decided to restrict their ambitions to the South market for the next couple of years as they see opportunity even down south. Amongst other South jewellers, Kalyan and Joyalukkas intend to add ~15-20 stores each this year through the owned store model whilst Malabar

Gold intends to add ~25-30 stores in FY19 largely through the franchisee route. PC Jeweller has guided for ~25-30 stores (90% via franchisees in FY19).

Player-wise leverage position



Source: Company, RoC, DRHP, HDFC sec Inst Research

Titan revised its gold exchange policy in March 2018. Made it more lucrative for consumers by reducing the commission it charges on exchange of gold.

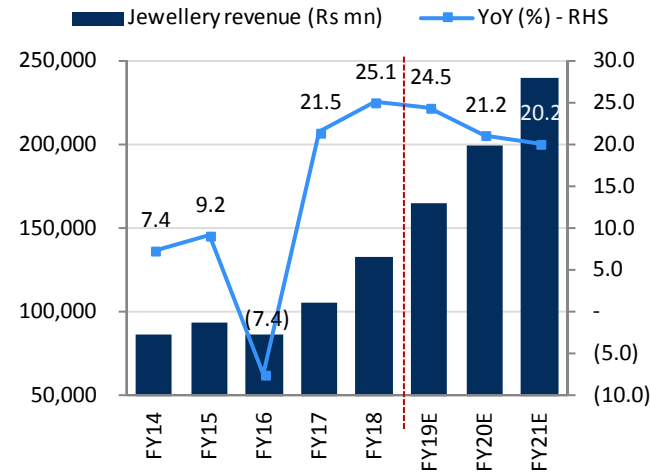
Titan now incurs a marginal cost in the exchange transaction vs making a margin on it earlier. Hence, could be gross margin dilutive; however increases avg. ticket sizes.

Loss in gross margin could be made up for at the EBIT level as the programme stokes SSSG.

Exercising operating levers crucial to sustain return profile

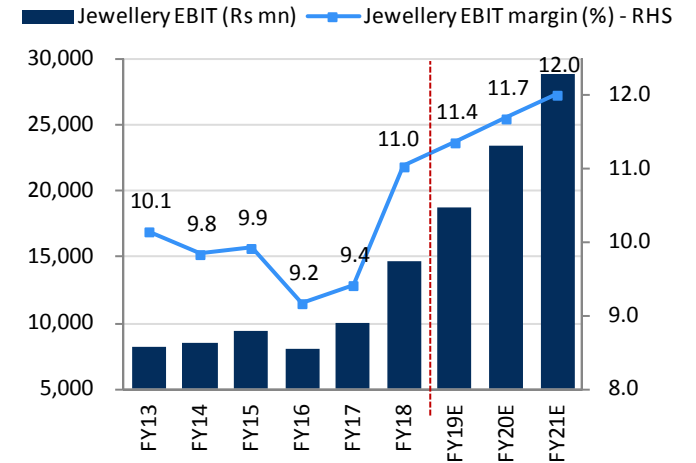
- **HVD could partly cushion the impact on gross margins caused by the aggression in the wedding segment. Both categories require a sizeable assortment for the consumer to choose from; therein lies the risk of deterioration in working capital efficiency**
- **Increased throughput through franchisees (currently L3 accounts for ~33% of jewellery revenue) and the revised exchange programme (given SSSG upside) could help partly cushion the deterioration in working capital efficiency.**
- **We factor in a marginal deterioration of the cash conversion cycle as a consequence from 107 days in FY18 to 116 days in FY21. This makes sales velocity and the consequent operating levers crucial for sustenance of return profile.**
- **HVD could play the role of a balancing lever for margins: Over FY16-18, Titan's jewellery EBIT margins improved ~190bps despite the thrust on the perceived lower-margin wedding segment (estimated to have grown at 35-40% over FY16-18E). While we suspect the improvement in studded ratio (170bps) to ~30% over FY16-18 may have had a role to play in stabilizing gross margins, wedding segment too is suspected to have delivered reasonable margins. However, as Titan penetrates further into the heartland of India, we do not expect the wedding segment to enjoy the same margins as before. Increased thrust on high-value diamond sales could partly cushion the impact on gross margins. (Our industry checks suggest that typically high-value diamond jewellery enjoy higher margins).**
- **Revised exchange programme to help stock SSSG: The SUPERPACK typically has ~50-70% repeat customers who are ideal candidates for an up-sell. We believe the exchange program could help stoke SSSG and consequently EBIT margins given the up-selling opportunity it presents. A consumer typically spends ~1.4-1.7x the value of the jewellery exchanged. This consumer purchasing behavior can be seen for Titan too. Over FY16-18, jewellery revenue grew at a CAGR of 23% and store additions clocked ~11% CAGR, implying the SSSG growth was a major contributor to jewellery growth. We reckon the underpinnings of this SSSG growth lies in the tactical shift Titan made in its gold sourcing route. It increased its sourcing from the exchange programme to 40% of jewellery sales (vs 20% in FY16). Given that Titan further intends to leverage the exchange programme (Sourcing via exchange expected to touch ~50% of sales by FY23E), it is plausible that the company achieves its target of ~12-13% SSSG CAGR over the next 5 years.**
- **Jewellery EBIT margins to inch up: We expect Titan to use its operating levers to ensure that it delivers on the EBIT margin front. Jewellery EBIT margins expected to improve by 100bps to ~12% over FY18-21E as the exchange program-led SSSG growth cushions the impact the program has at the gross margin level.**

Jewellery top-line to grow at 22% CAGR (FY18-21E)



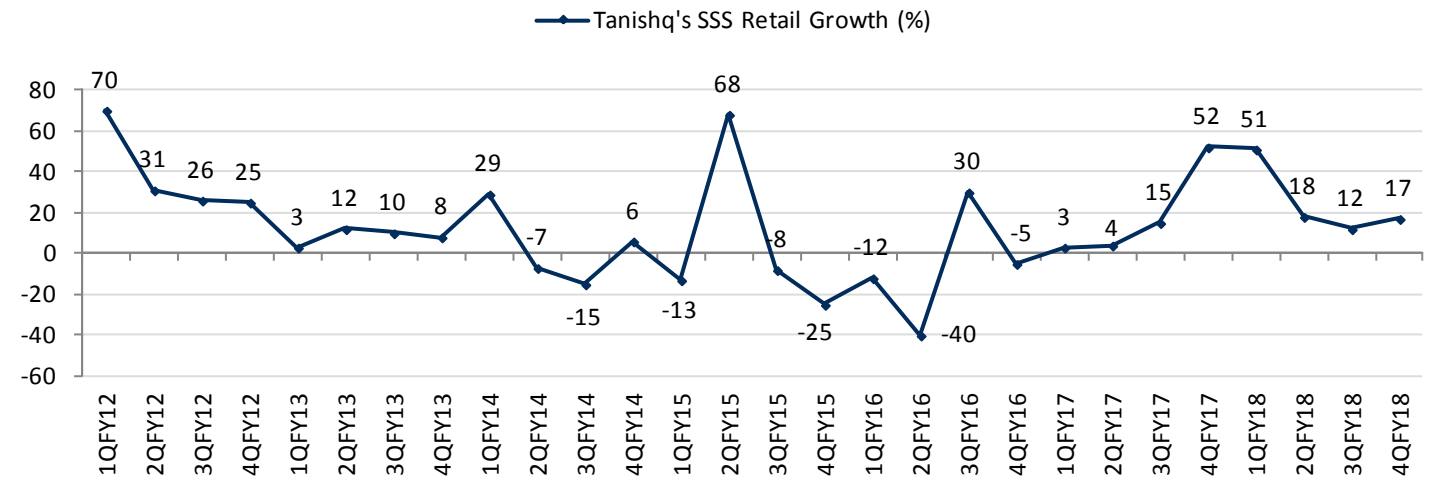
Source: Company, HDFC sec Inst Research

Jewellery EBIT margins to inch up



Source: Company, HDFC sec Inst Research

Tanishq's SSS Retail growth trend

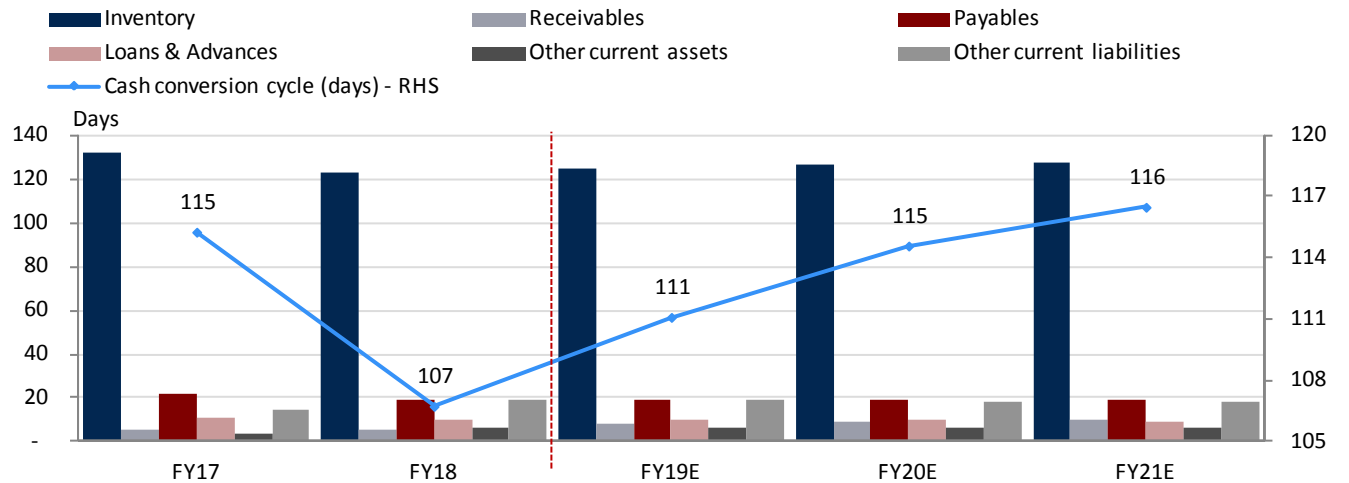


Source: Company, HDFC sec Inst Research

- Expect a marginal deterioration in cash conversion cycle:** We reckon the cash conversion cycle typically improves as 1. sourcing from the exchange programme increases as can be seen over FY16-18. 2. L3 throughput increases as a % of total revenue over FY18-21E. However, given the thrust on wedding and

HVD sales, we expect a marginal deterioration in the cash conversion cycle from ~107 days to ~116 days over FY18-21E on a net basis. (Note: we exclude gold loan and Golden Harvest Scheme (GHS) advances from our computation of the cash conversion cycle as we classify them as debt).

Cash conversion cycle to inch up as wedding and HVD’s share increases

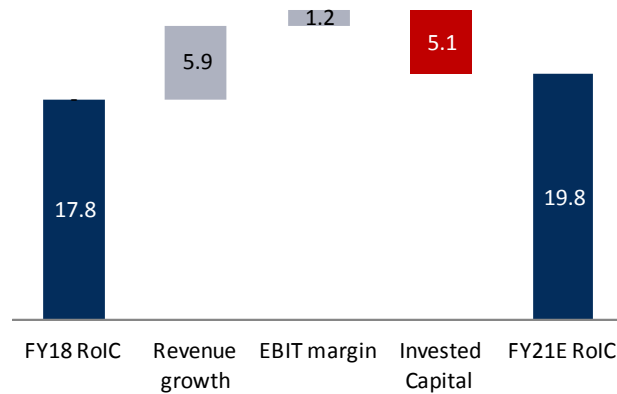


Source: Company, HDFC sec Inst Research

- Ergo, sales velocity and operating levers become crucial to sustain return profile:** Given that working capital intensity is expected to inch up from current levels and gross margin levers to remain capped, sales velocity and subsequent operating levers become crucial if Titan intends to sustain its return

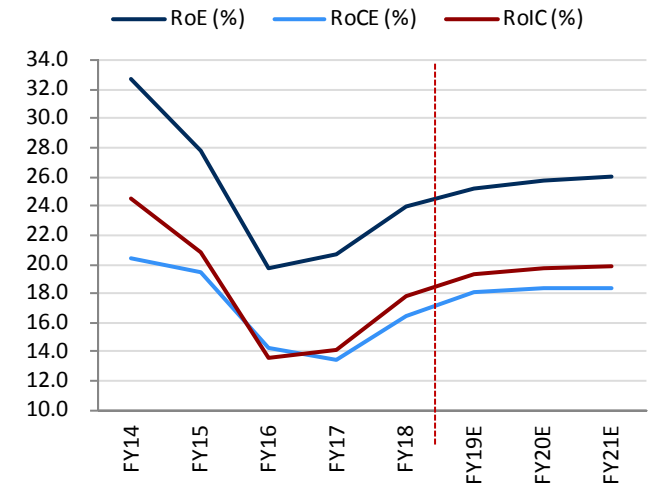
profile. We believe Titan will manage to improve its RoCE by ~190bps in Phase 1 (FY18-21E) to 18.3% courtesy its 1-2 year head-start on capital and designs vs peers. However the increase in competitive intensity in Phase 2 (FY21-29E). will keep RoCEs stagnant.

Sales velocity/op. leverage key to sustain RoIC



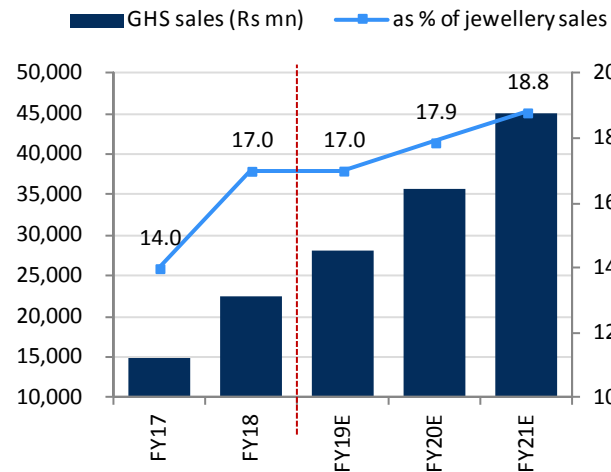
Source: Company, HDFC sec Inst Research

Titan: Return profile



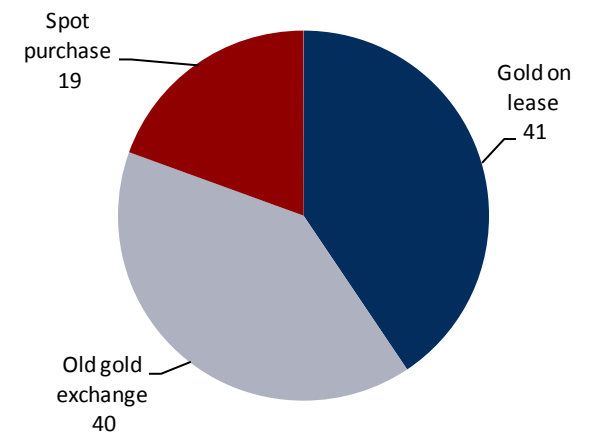
Source: Company, HDFC sec Inst Research

Expect GHS' contribution to inch up



Source: Company, HDFC sec Inst Research

FY18: Estimated Gold sourcing

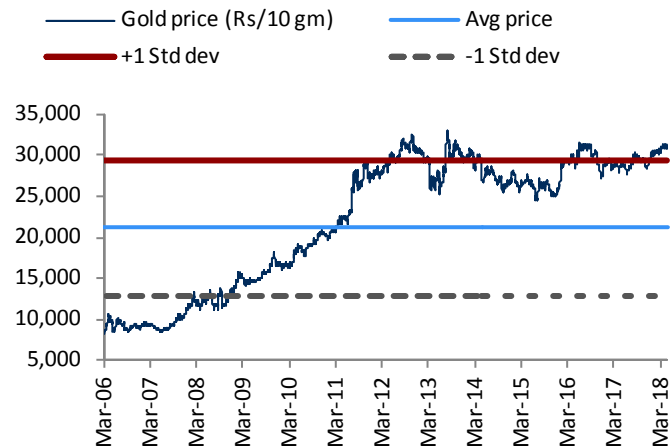


Source: Company, HDFC sec Inst Research, RoC – FY17 financials

Titan's GHS has been a hero product and has helped the company in customer acquisition. This too is expected to contribute more

- Elevated gold prices could stoke up franchisee throughput and roll-outs:** Given the deteriorating macros, we believe we have entered a stable-to-rising gold price environment, making it conducive for stoking up inventory purchases/throughput of Titan’s

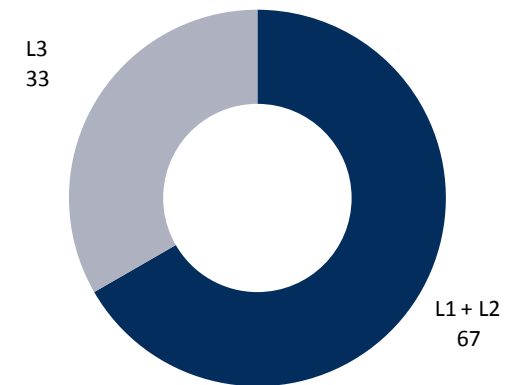
Gold prices near its peak



Source: Company, HDFC sec Inst Research

L3 (FOFO) channel (~est: 33% of jewellery revenues). Franchisee roll-outs could increase too. This is evident in Titan’s guidance of ~40-45 store additions (85-90% through franchisees) in FY19.

Channel-wise revenue mix (%)



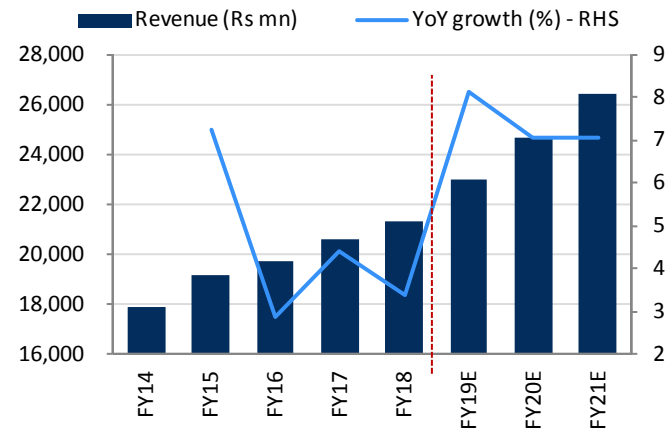
Source: Company, HDFC sec Inst Research

Watches: A play on smart tech, design and channels

- **Category attraction issues persist in watches**
- **FY18 marked a recovery; execution on smart tech, design and channels – key for a turnaround**
- **Expect watches segment to clock ~7% CAGR over FY18-21E with improving margins**
- **Category attraction issues persist in watches:** India's Rs 85bn watches market continues facing category attraction issues as the ubiquitous smartphone decreases the need for a separate timepiece. The market is fraught with discounts and while Titan

continues to be a market leader - enjoys ~25% share in the overall watch market/~65% in the organized market (sold ~15m pieces in FY18), it is increasingly competing with global players (mobile companies) with deep pockets and new entrants in smart watches, wearables and other non-watch categories. Titan's ability to introduce smart watches ahead of mobile companies which straddle across price points will be key for it to sustain interest in this category.

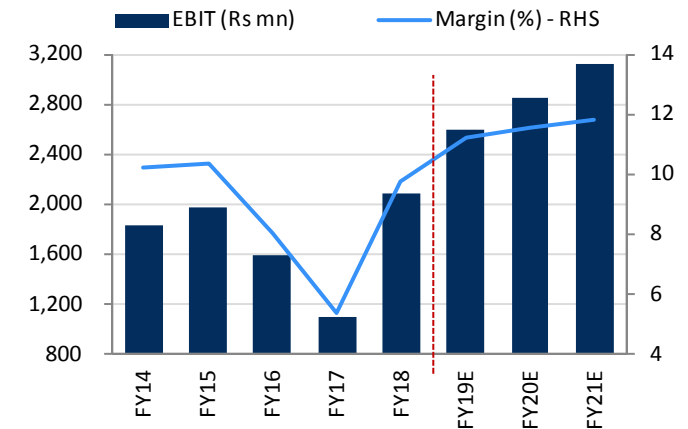
Watches: Revenue, YoY



Source: Company, HDFC sec Inst Research

- **FY18 marked a recovery:** The watches segment has grown at a weak 5% CAGR over FY13-18, while margins nearly halved over FY13-17 given the competitive landscape and investments in new brands such as Favre Leuba. However, the company did see a pick-up in profitability in FY18 underpinned by 1. A pick up in mature brands such as fastrack, 2. Good traction in new product launches (Ceramic Edge, Titan We, Raga Masaba). 3. Growth in Rs

Watches: EBIT, EBIT margin (%)



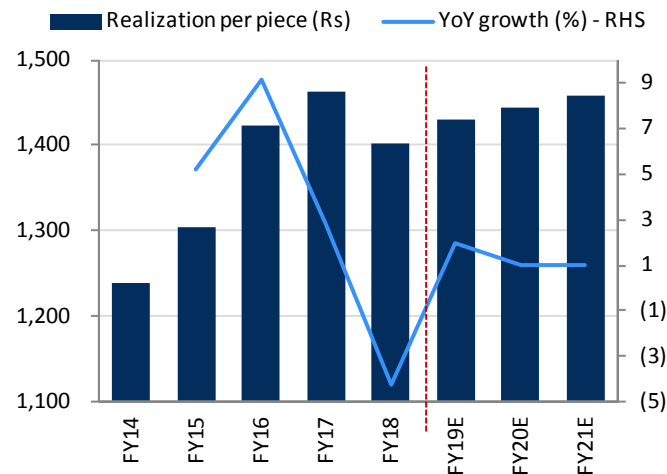
Source: Company, HDFC sec Inst Research

4,000+ price-point products was higher than overall growth, implying the premiumization theme played out, 4. Successful execution of its cost-cutting initiatives (curbing discounts in trade channels, re-organization of the service vertical, consolidation of large format stores, VRS scheme to reduce employee costs, higher local procurement and renegotiation of media contracts).

- **Execution on smart tech, design and channels – key for a turnaround:** We believe Titan could see a revival in its watches biz as 1. Pipeline of product launches remains healthy. 2. Titan intends to deliver smart watches straddled across price points and across brands, 3. Focus remains on revving up both volumes (through Sonata and Fastrack) and

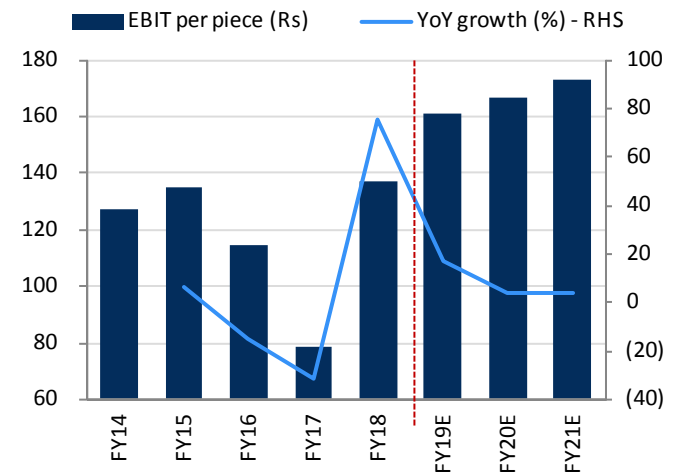
premiumization (Xylys and Raga), 4. Healthy store additions planned (~40 stores) in FY19, 5. Focus is to push more through effective channels such as E-Commerce and Multi-Brand Outlets, thereby aiding sales as well margins. We expect Titan’s watches segment to grow at a CAGR of ~7.4% over FY18-21E with a 200bps improvement in margins.

Watches: Estimated realization per piece



Source: Company, HDFC sec Inst Research

Watches: Estimated. EBIT per piece



Source: Company, HDFC sec Inst Research

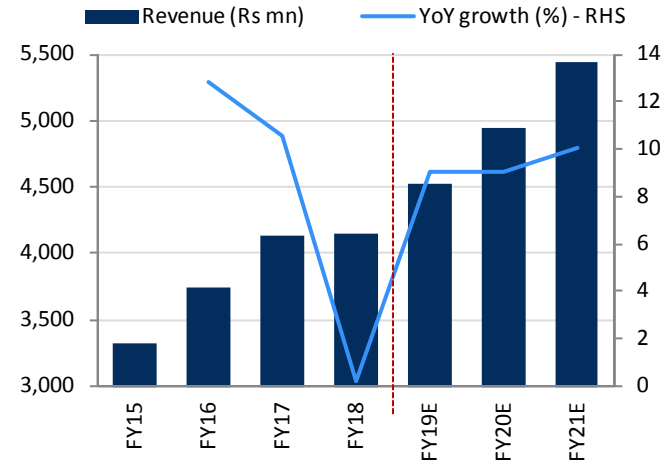
Eyewear: Investment mode on

- **The Rs 70bn prescription eyewear category is a category entered out of force. Industry remains highly competitive and fraught with disruptive offers by competitors.**
 - **Titan's eyewear biz can be divided into 2 segments 1. Prescription eyewear 2. Sunglasses. Profitability in the former remains challenged given the disruptive offers by strong competitors whilst the latter (a dealer-led biz) continues to struggle as restocking levels remain low given most dealers still remain skeptical of registering under the new GST regime.**
 - **Expect the eyewear biz to grow at 9% CAGR over FY18-21.**
- **What has been the hurdle?** A typical prescription eyewear biz is a high-fixed cost biz and hence requires scale to be in the money. Titan's eyewear biz can be divided into two segments 1. Prescription eyewear, 2. Sunglasses. Profitability in the former remains challenged given the disruptive offers by strong competitors like Lenskart. Also, Titan's premium brand perception has not helped either and hence sales velocity remains subdued. The Sunglasses biz continues to struggle since it is predominantly dealer-led and most dealers still remain skeptical of registering under the new GST regime, consequently, restocking levels remain low. Whilst eyewear revenue

grew at a CAGR of ~8% over FY15-18 to Rs 4.15bn, profitability has been on the decline.

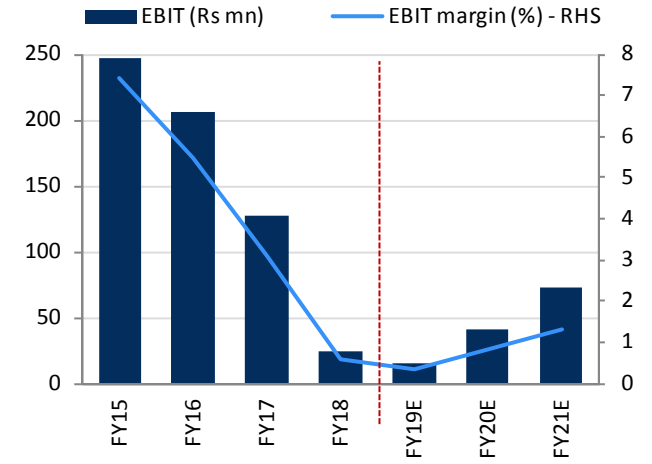
- **What's Titan doing to fix it?** 1. To correct the premium brand perception, Titan plans to launch products at lower price points, especially in the sub-Rs 500 and sub-Rs 1000 price range. This would be supported by a ramp-up in marketing spends with a clear intention to improve brand salience and acquire new customers, 2. Customer service would be used as a key differentiator vs. competition. 3. To expand reach, Titan intends to ramp up store expansion and open 40 new stores in FY19 (vs. 22 stores opened in FY18). Further, it would commence sale of branded frames through its distribution channels and is looking to aggregate smaller unorganized stores under the Titan Eyeplus brand. All these initiatives are expected to aid SSSG growth and quadruple its customer base to 10mn (vs ~2.4mn currently).
- **Expect eyewear biz to clock ~9% CAGR over FY18-21E:** Given the above initiatives, we expect the eyewear biz to recover and grow at ~9% CAGR over FY18-21E, however improvement in profitability is only expected to be gradual given the marketing investments needed to spur growth. Expect eyewear EBIT margins to improve by ~80bps over FY18-21E to ~1.3%.

Eyewear: Revenue, YoY growth



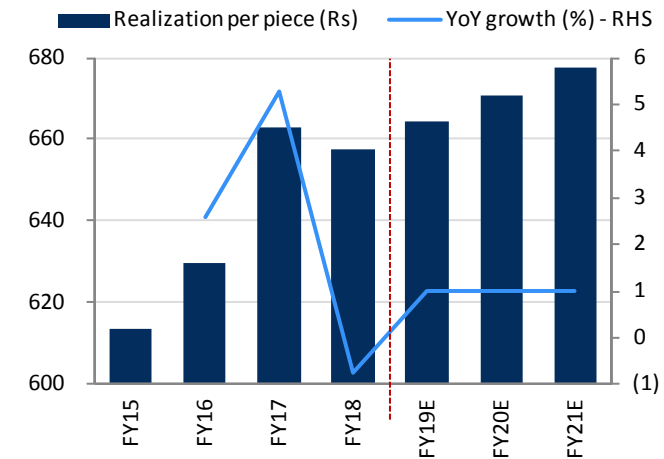
Source: Company, HDFC sec Inst Research

Eyewear: EBIT, EBIT margin



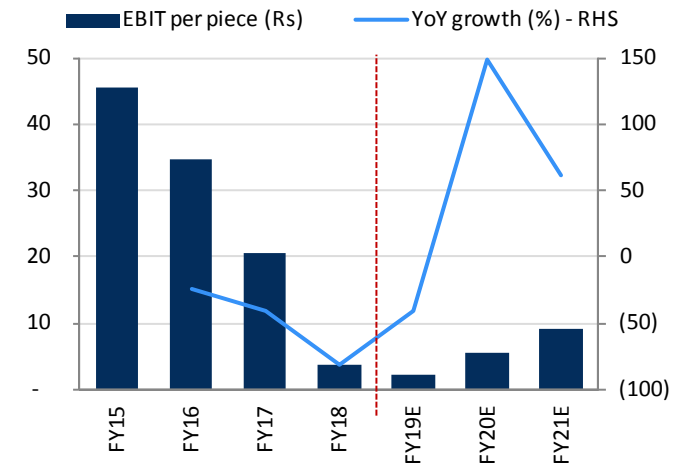
Source: Company, HDFC sec Inst Research

Eyewear: Estimated Realization per piece



Source: Company, HDFC sec Inst Research

Eyewear: Estimated EBIT per piece



Source: Company, HDFC sec Inst Research

Tailwinds baked in

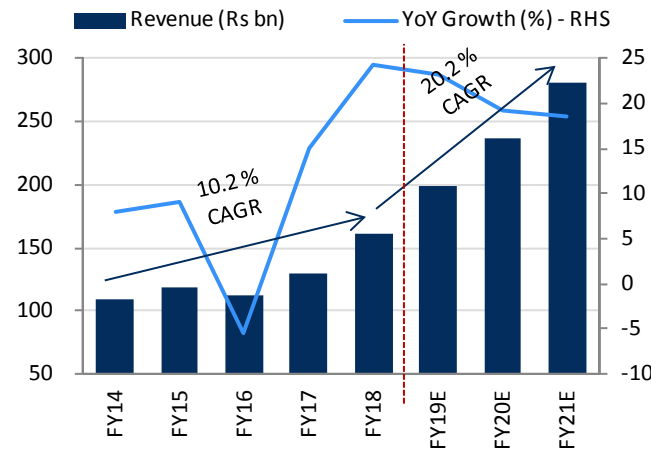
Valuations keep us at bay

- Expect Titan to deliver on its 2.5x FY18 jewellery revenue aspiration:** Over FY15-18, Titan jewellery biz grew by ~12% CAGR while its non-jewellery biz grew at ~6% CAGR. The modest performance in jewellery was despite an unfavorable regulatory stance towards organized jewellery. However, the current regulatory wind underneath the organized jewellers' wings is expected to aid top jewellers to gain market share. In case of Titan, given its capital and design arbitrage vs peers, we expect the company to gain more than its fair share from the market, atleast in

Phase 1 (FY18-21E). Given these underpinnings, we expect Titan to deliver on its ambitious 2.5x FY18 jewellery revenue target by FY23E. Overall, we expect Titan to deliver 20% revenue CAGR with jewellery sales growing at 22% CAGR and Non-jewellery revenue growing at 9% CAGR over FY18-21E.

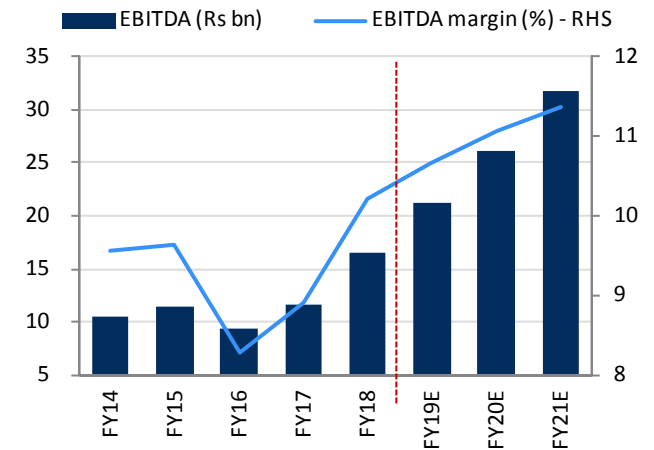
- EBITDA margins to inch up by 120bps as operating leverage kicks in:** Strong sales velocity, a stable gross margins profile and operating levers are expected to improve EBITDA margins. We factor in a ~120bps margin improvement over FY18-21E.

Revenue to grow at 20% CAGR over FY18-21E



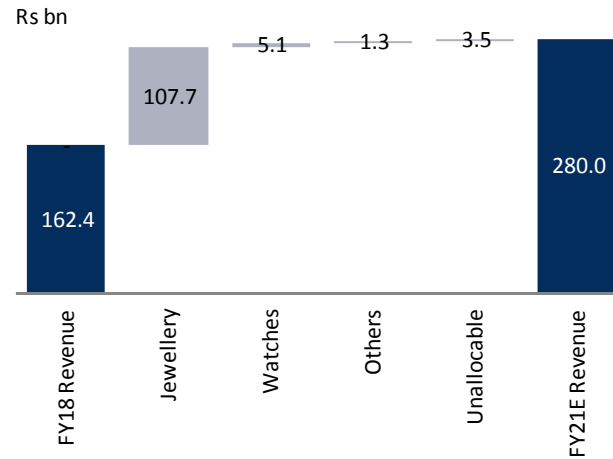
Source: Company, HDFC sec Inst Research

EBITDA to grow at 25% CAGR, margins



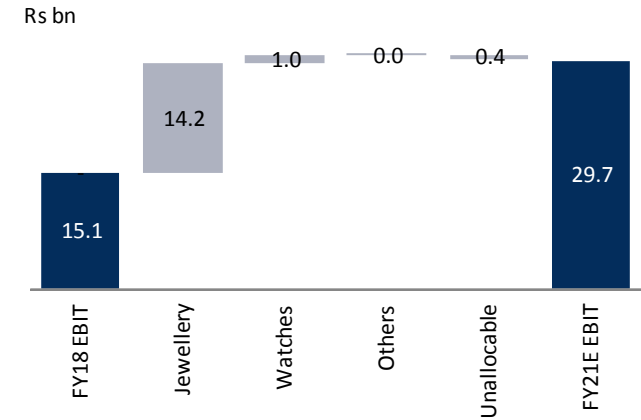
Source: Company, HDFC sec Inst Research

Jewellery to contribute bulk of revenue



Source: Company, HDFC sec Inst Research

...Ditto for EBIT

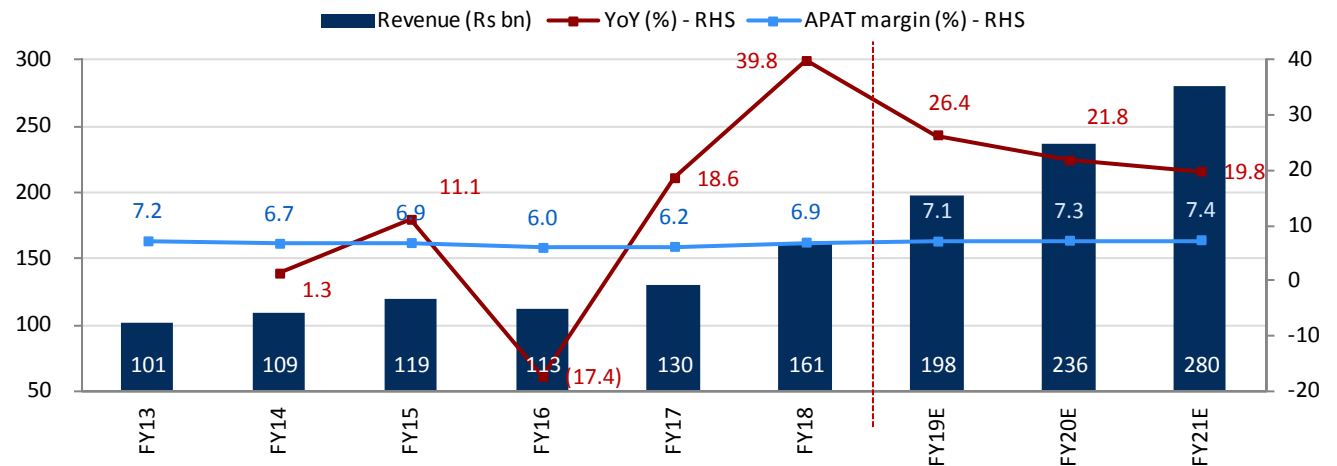


Source: Company, HDFC sec Inst Research

■ **Expect 23% earnings CAGR over FY18-21E:** A 20% revenue growth with a 100bps EBIT margin expansion

is expected to rev up earnings at 23% CAGR over FY18-21E.

APAT to grow at 23% CAGR over FY18-21E



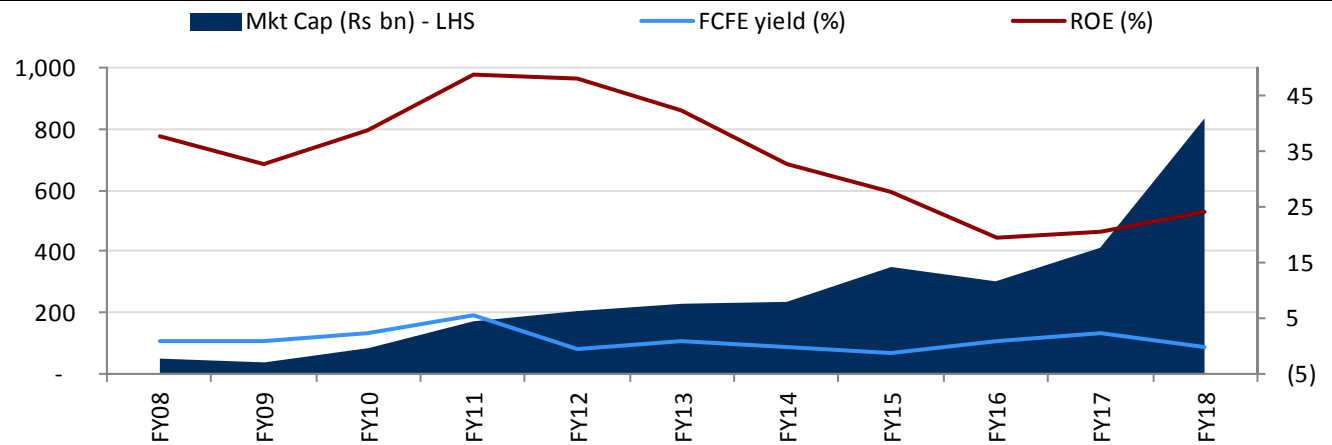
Source: Company, HDFC sec Inst Research

85%+ of cash generated has gone towards WC and capex over FY15-18

	FY15	FY16	FY17	FY18	Total
[A] Sources of funds (Rs bn)					
Cash from Operations (excl WC change)	9.2	7.4	8.0	12.0	36.6
Other Income	0.8	0.6	0.4	0.1	1.8
Total	9.9	8.0	8.4	12.1	38.4
[B] Application of funds (Rs bn)					
Working Capital	2.8	10.0	(2.2)	8.8	19.3
Capex	2.1	2.5	6.3	2.9	13.9
Investments	(0.1)	(0.4)	4.3	(3.9)	(0.1)
Dividend	2.2	4.8	0.0	2.8	9.7
Borrowings	10.6	(9.1)	(5.0)	3.2	(0.2)
Others	(1.4)	0.9	(0.6)	(0.1)	(1.2)
Net change in cash	(6.2)	(0.9)	5.6	(1.6)	(3.1)
Total	9.9	8.0	8.4	12.1	38.4
Cumm. WC + Capex (As % of cumm. cash generated)					86.4

Source: Company, HDFC sec Inst Research

FCFE yield near its lowest in a decade



Source: Company, HDFC sec Inst Research

Valuation

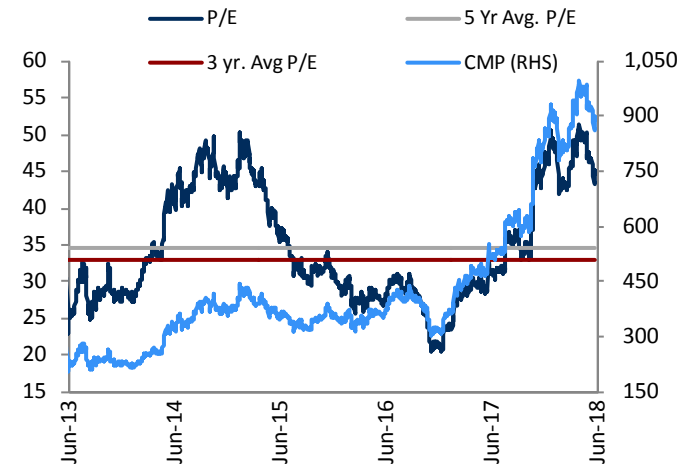
1 year forward P/E band



Source: Bloomberg, HDFC sec Inst Research

- **Our DCF bakes in all plausible tailwinds; NEUTRAL:** Our 4-stage DCF-based TP of Rs 820/sh factors in all plausible revenue and margin tailwinds as mentioned in our arguments. TP implies a P/E of 42x FY20E earnings (20% premium vs 5-year, 2-year forward P/E). Valuations keep us at bay. Recommend a neutral stance on the name. Underlying DCF assumptions - WACC of 10.3% - factors in 1. Cost of equity of 13.5% [Long-term index expected returns x (1-LTCG)], 2. Post-tax cost of debt of 3.4% (Note. We include GML and advances from customers as part of debt and hence, the effective rate is low).
- **Stage 1: FY18-23E:** We build in 20% jewellery revenue CAGR as 1. Capital position of key peers and wider design portfolio may give Titan a headstart in

2 year forward P/E band



Source: Bloomberg, HDFC sec Inst Research

- network expansion and SSSG. Non-jewellery expected to grow at 9% CAGR during this period. FCFE is expected to grow ~27% CAGR over FY19-23E and RoCE is expected to improve by ~220bps over this period.
- **Stage 2: FY23-29E:** We build in 12.6% jewellery revenue CAGR as top challengers catch-up on capital, hence expansion and designs. Non-jewellery expected grow at 9% CAGR during this period. FCFE is expected to grow at ~22% CAGR over FY23-29E and RoCE is expected to remain flat over this period.
- **Stage 3: FY29-40E:** FCFE expected to grow at 10% CAGR.
- **Stage 4 (Terminal stage):** Assumed a terminal growth rate of 5%.

DCF

(Rs mn)	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E
Revenue (Rs mn)	236,412	279,992	325,313	375,269	430,177	485,424	547,900	613,251	680,874	749,772
YoY	19.1	18.4	16.2	15.4	14.6	12.8	12.9	11.9	11.0	10.1
No. of stores (#)	408	443	473	503	523	543	563	583	603	623
YoY	9.4	8.6	6.8	6.3	4.0	3.8	3.7	3.6	3.4	3.3
EBIT*(1-t)	16,990	20,339	24,342	28,655	33,648	39,078	45,034	51,860	58,290	65,455
Depreciation	2,223	2,758	3,311	3,877	4,465	5,083	5,724	6,381	7,045	7,741
Capex	(4,566)	(5,164)	(5,448)	(5,605)	(6,041)	(6,409)	(6,717)	(6,967)	(7,118)	(7,869)
Changes in WC (Winv)	(13,389)	(14,915)	(16,391)	(16,982)	(18,275)	(17,870)	(20,411)	(21,163)	(22,831)	(22,406)
FCFF	1,258	3,018	5,814	9,946	13,797	19,881	23,630	30,111	35,385	42,922
YoY (%)	(49.4)	139.9	92.6	71.1	38.7	44.1	18.9	27.4	17.5	21.3
Interest (1-t)	(396)	(409)	(426)	(459)	(518)	(592)	(671)	(756)	(845)	(936)
Net Borrowings	5,536	6,440	6,894	7,921	11,162	10,311	11,858	12,915	14,163	14,871
FCFE	6,398	9,048	12,283	17,407	24,441	29,600	34,817	42,270	48,703	56,857
YoY (%)	(2.9)	41.4	35.7	41.7	40.4	21.1	17.6	21.4	15.2	16.7
Period No.	-	1	2	3	4	5	6	7	8	9
PV (FCFF)	1,258	2,735	4,776	7,404	9,308	12,156	13,094	15,122	16,106	17,705
Terminal Value										3,002,250
Kd	5.2%									
Kd*(1-t)	3.4%									
Ke	13.5%									
Net Debt (Mar-19E)	22,345									
PV-Explicit Period	330,460									
PV-Terminal Value	419,593									
Equity Value (Rs mn)	727,708									
Equity value per share (INR)	820									
FY20 Implied P/E (x)	42									
Terminal growth rate (%)	5.0%									
WACC	10.3%									
Terminal FCF multiple (x)	19.7									
No. of shares (mn)	888									
CMP	897									
Upside/(Downside)	-8.6%									

Source: Company, HDFC sec Inst Research

- **Current price implies:** CMP suggests that Titan continues its scorching growth rate in jewellery over

Phase 2 (FY21-29E) too, which in our view, even for a brand like Titan is a stretch.

Reverse DCF (Rs mn)

	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E
Revenue (Rs mn)	236,412	284,171	340,388	408,235	486,821	581,011	694,064	829,513	992,180	1,148,501
YoY	19.1	20.2	19.8	19.9	19.3	19.3	19.5	19.5	19.6	15.8
No. of stores (#)	408	443	473	503	523	543	563	583	603	623
YoY	9.4	8.6	6.8	6.3	4.0	3.8	3.7	3.6	3.4	3.3
EBIT*(1-t)	16,990	20,670	25,567	31,374	38,405	47,315	57,851	71,308	86,579	102,275
Depreciation	2,223	2,760	3,325	3,921	4,565	5,274	6,052	6,900	7,821	8,856
Capex	(4,566)	(5,206)	(5,621)	(5,989)	(6,713)	(7,475)	(8,288)	(9,141)	(10,019)	(11,774)
Changes in WC (Winv)	(13,389)	(16,220)	(19,900)	(22,786)	(25,979)	(30,467)	(36,825)	(43,863)	(54,037)	(50,836)
FCFF	1,258	2,004	3,371	6,520	10,278	14,647	18,789	25,204	30,344	48,521
YoY (%)	(49.4)	59.3	68.2	93.4	57.6	42.5	28.3	34.1	20.4	59.9
Interest (1-t)	(396)	(413)	(441)	(495)	(583)	(703)	(848)	(1,022)	(1,231)	(1,456)
Net Borrowings	5,536	6,897	8,106	9,976	14,220	15,405	18,997	23,245	28,844	31,192
FCFE	6,398	8,488	11,036	16,001	23,915	29,349	36,939	47,428	57,957	78,257
YoY (%)	(2.9)	32.7	30.0	45.0	49.5	22.7	25.9	28.4	22.2	35.0
Period No.	-	1	2	3	4	5	6	7	8	9
PV (FCFF)	1,258	1,816	2,769	4,854	6,934	8,956	10,412	12,658	13,811	20,015
Terminal Value										3,393,939
Kd	5.2%									
Kd*(1-t)	3.4%									
Ke	13.5%									
Net Debt (Mar-20E)	22,345									
PV-Explicit Period	344,553									
PV-Terminal Value	474,335									
Equity Value (Rs mn)	796,543									
Equity value per share (INR)	897									
FY20 Implied P/E (x)	46									
Terminal growth rate (%)	5.0%									
WACC	10.3%									
Terminal FCF multiple (x)	19.7									
No. of shares (mn)	888									
CMP	897									
Upside/(Downside)	0.0%									

Source: Company, HDFC sec Inst Research

Titan: Key Assumptions

	FY12	FY13	FY14	FY15	FY16	FY17	FY18E	FY19E	FY20E
Jewellery Biz									
Net Revenue (Rs mn)	69,898	80,324	86,274	94,206	87,227	105,964	132,569	164,991	199,959
YoY (%)	39.5	14.9	7.4	9.2	(7.4)	21.5	25.1	24.5	21.2
-Gold Jewellery	51,725	58,636	60,392	64,060	62,803	74,599	93,175	115,468	139,341
YoY (%)	37.6	13.4	3.0	6.1	-2.0	18.8	24.9	23.9	20.7
-Studded Jewellery	18,174	21,687	25,882	30,146	24,423	31,365	39,393	49,523	60,618
YoY (%)	45.0	19.3	19.3	16.5	-19.0	28.4	25.6	25.7	22.4
EBITDA (Rs mn)	6,393	8,360	8,728	9,694	8,388	10,311	15,009	19,175	23,839
YoY (%)	41.9	30.8	4.4	11.1	-13.5	22.9	45.6	27.8	24.3
EBITDA margin (%)	9	10.4	10.1	10.3	9.6	9.7	11.3	11.6	11.9
Total gold sold (tonnes)	19.3	19.4	18.6	20.1	20.0	21.0	25.9	31.4	36.8
YoY (%)	7.6	0.6	-4.3	8.3	-0.6	5.1	23.1	21.4	17.2
Average gold price (Rs/gm)	25,685	30,180	28,279	27,685	27,311	30,862	30,708	31,629	32,578
YoY (%)	33.6	17.5	-6.3	-2.1	-1.4	13.0	-0.5	3.0	3.0
Studded share (%)	26.0	27.0	30.0	32.0	28.0	29.6	29.7	30.0	30.3
Total no. of stores	163	179	198	209	227	286	330	373	408
Revenue/store (Rs mn)	441	470	458	463	400	413	430	469	512
EBITDA/store (Rs mn)	40	49	46	48	38	40	49	55	61
Revenue per sq ft (Rs)	-	150,281	129,858	122,900	101,671	113,432	128,137	139,809	152,253
Watches Biz									
Net revenues (Rs mn)	15,284	16,774	17,889	19,188	19,744	20,611	21,315	23,046	24,673
YoY (%)	20.1	9.8	6.6	7.3	2.9	4.4	3.4	8.1	7.1
EBITDA (Rs mn)	2,266	2,151	2,075	2,293	1,953	1,464	2,459	2,996	3,282
YoY (%)	11.9	-5.1	-3.5	10.5	-14.8	-25.1	68.0	21.9	9.5
EBITDA margin (%)	14.8	12.8	11.6	12.0	9.9	7.1	11.5	13.0	13.3
Watches sold (mn pieces)	15.7	15.4	14.4	14.7	13.9	14.1	15.2	16.1	17.1
YoY (%)	15.4	-2.2	-6.0	2.0	-5.8	1.5	8.0	6.0	6.0
Eyewear Biz									
Net revenues (Rs mn)				3,320	3,745	4,140	4,150	4,527	4,938
YoY (%)					12.8	10.5	0.2	9.1	9.1
EBITDA (Rs mn)				320	296	238	134	136	173
YoY (%)					-7.6	-19.5	-43.5	1.1	27.3
EBITDA margin (%)				9.6	7.9	5.7	3.2	3.0	3.5
Eyewear sold (mn)				5.4	5.9	6.2	6.3	6.8	7.4
YoY (%)					10.0	5.0	1.0	8.0	8.0
Other Biz									
Net revenues (Rs mn)	3,303	4,135	5,111	2,421	3,124	3,811	4,415	5,209	6,147

Source: Company, HDFC sec Inst Research

Key Risks

Name	Description
Volatility in gold, silver and diamond prices	Any material fluctuations in gold, silver and diamond prices might affect the profitability of the company.
Delay in store rollout plans	Any delay in setting up new stores will make it difficult for the company to meet our revenue and earnings estimates.
Inventory risk	Any material misjudgment in estimating customer demand could adversely impact the results by causing either a shortage of inventory or an accumulation of excess inventory.
Changing regulations	The regulatory environment in which company operates is evolving and is subject to change. The Government of India may implement new laws or other regulations that could adversely affect the company's operations.
Maintaining and developing the brand	Brand is crucial factor for the success in the jewellery business. Any negative publicity with respect to business could adversely impact the company's business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

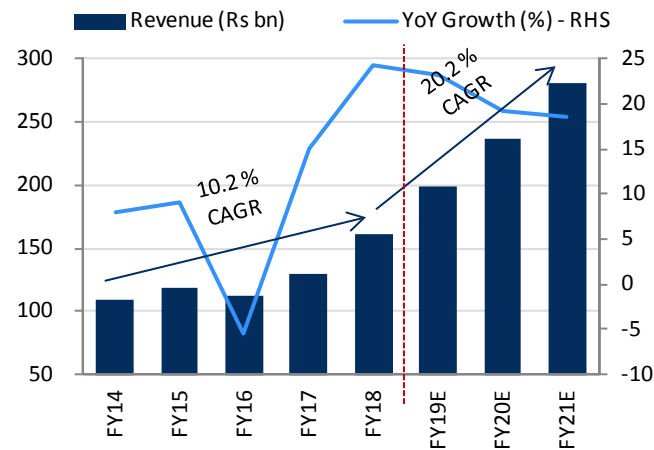
Key Personnel

Name	Designation	Description
Mr. Bhaskar Bhat	Managing Director	He assumed the position of Managing Director in 2002. Most of Bhaskar's working experience has been in Sales & Marketing. He started his career as a Management Trainee at Godrej & Boyce Manufacturing in 1978. After spending five years at Godrej, he joined the Tata Watch Project in 1983, which later became Titan Company Ltd.
Mr. C K Venkataraman	CEO - Jewellery	He has headed the Jewellery division since 2005. He joined Titan Company Limited in 1990, and worked in the Advertising and Marketing functions before becoming the Head of Sales & Marketing for the Titan brand in 2003.
Mr. S Ravi Kant	CEO - Watches & Accessories	He joined Titan in 1988 as Head- Direct Marketing and moved on to head Retailing, followed by Exports. After managing international businesses for watches and jewellery for over a decade, he took over the watches business in 2015
Mr. Ronnie Talati	CEO - Eyewear	He joined Tata Press in 1976. In 2005 he headed the new business unit to target youth. Thus 'Fastrack' came into existence. In 2013, Mr. Talati took over as the Chief Marketing Officer of Watches & Accessories Division.
Mr. S Subramaniam	CFO & Head Of IT Function	A CA and ICWA by profession, he has over 25 years of experience in Finance and Business roles. Mr. Subramaniam has been driving strategic finance & has been a part of the top management teams for the past 10 years.

Source: Company, HDFC sec Inst Research

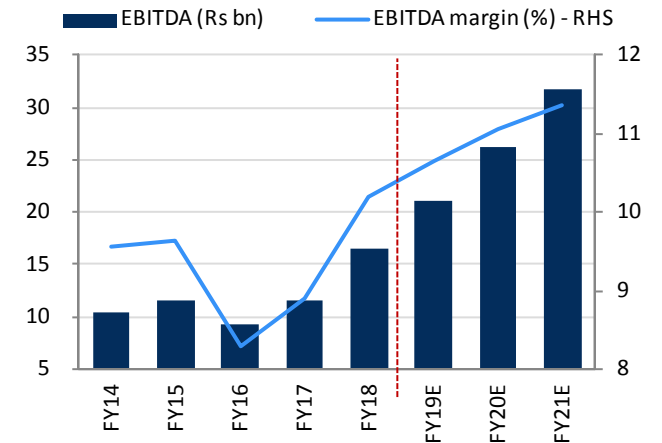
Story in Charts

Revenue to grow at 20% CAGR over FY18-21E



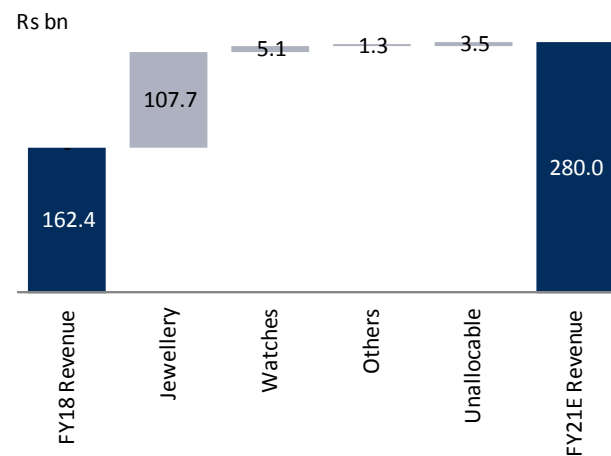
Source: Company, HDFC sec Inst Research

EBITDA to grow at 25% CAGR, margins



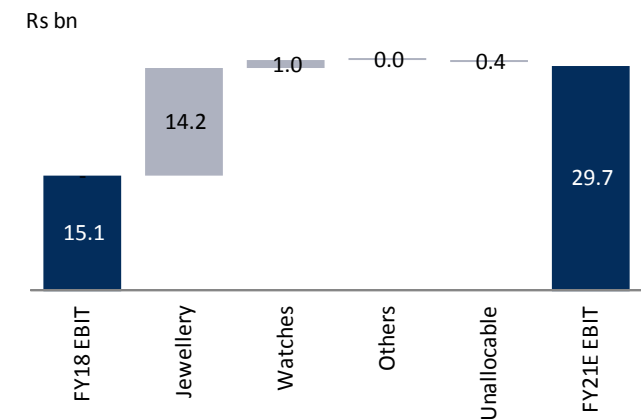
Source: Company, HDFC sec Inst Research

Jewellery to contribute bulk of revenue



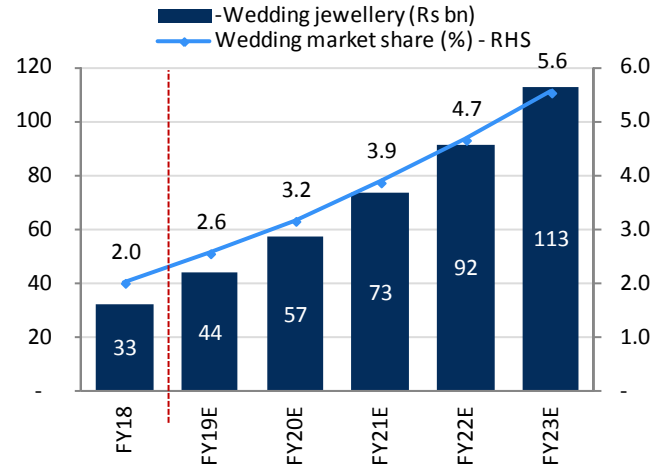
Source: Company, HDFC sec Inst Research

...Ditto for EBIT



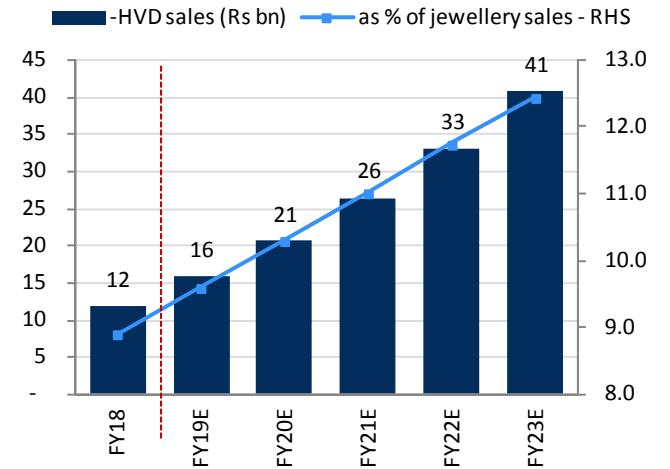
Source: Company, HDFC sec Inst Research

Titan: Est. growth in wedding segment, market share (%)



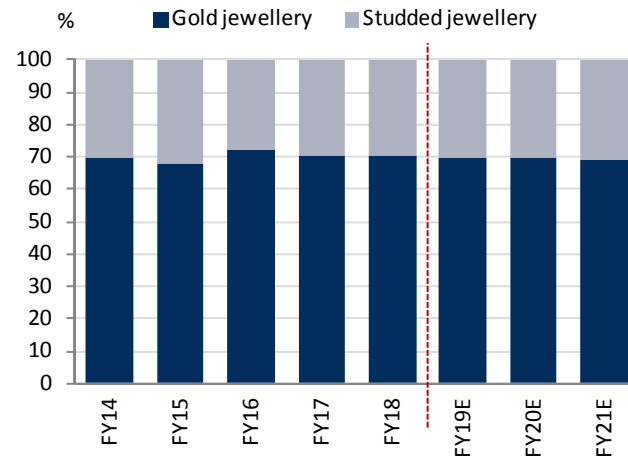
Source: Company, HDFC sec Inst Research

...HVD to inch up too



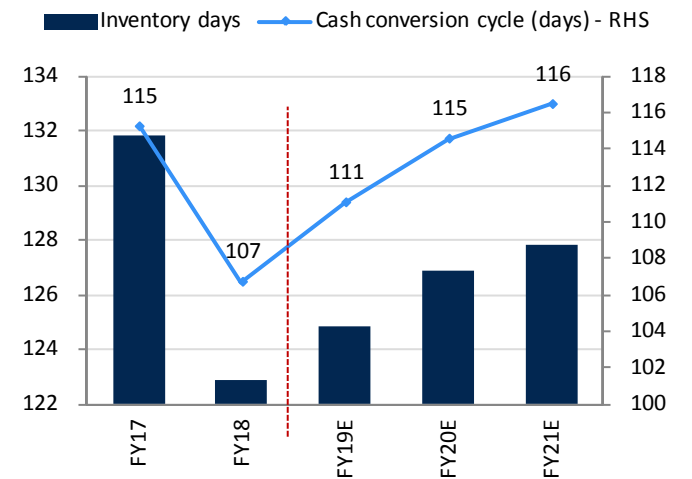
Source: Company, HDFC sec Inst Research

Jewellery mix has largely remained stable



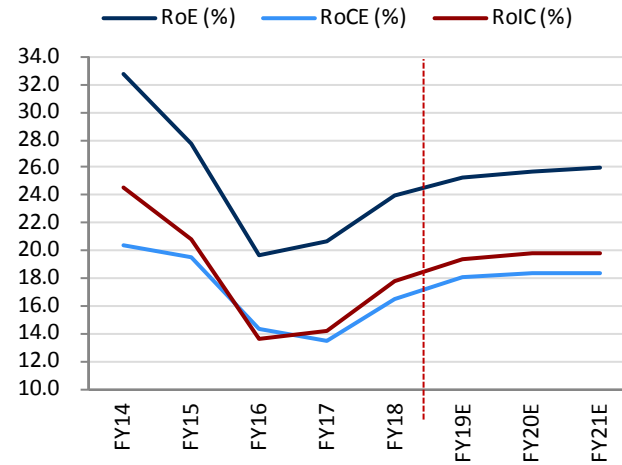
Source: Company, HDFC sec Inst Research

Cash conversion cycle to inch up as wedding and HVD's share increases



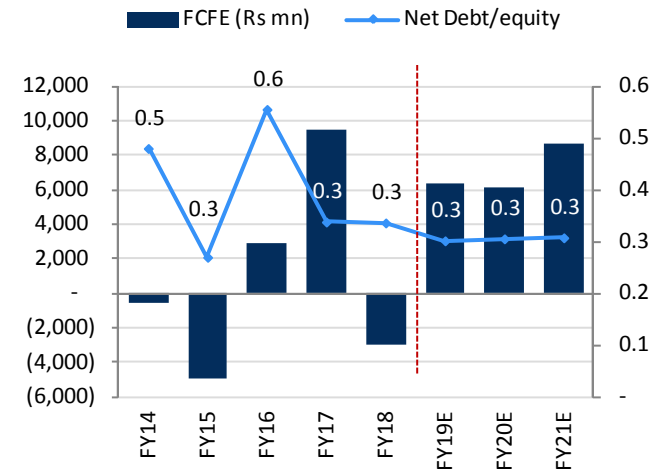
Source: Company, HDFC sec Inst Research

Titan: Return profile



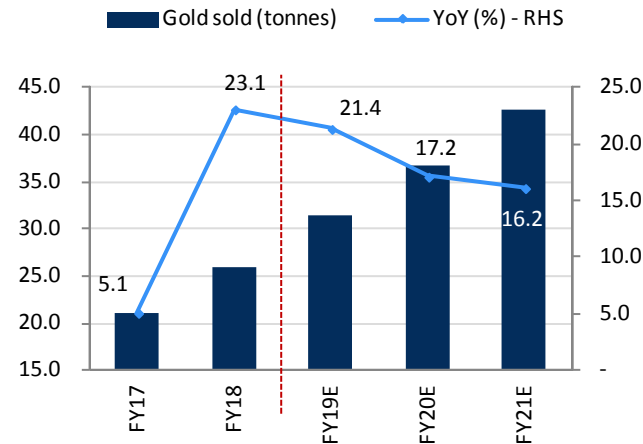
Source: Company, HDFC sec Inst Research

Titan: Leverage and FCFE profile



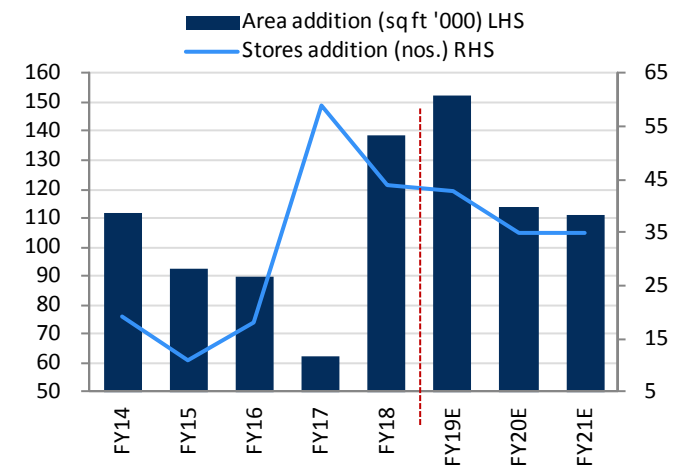
Source: Company, HDFC sec Inst Research

Titan: Estimated gold volume sold (tonnes)



Source: Company, HDFC sec Inst Research

Expected to add ~380k sq feet over FY18-21E



Source: Company, HDFC sec Inst Research

Company Profile: The Titan Company

Titan is a manufacturing company that produces India's largest and best-known range of personal accessories — watches, jewellery, sunglasses and prescription eyewear. The company is a joint venture between Tata and the Tamil Nadu Industrial Development Corporation. It commenced operations in 1984 under the name Titan Watches Limited. In 1994, Titan diversified into jewellery with Tanishq and subsequently into eyewear with Titan Eyeplus. In 2013, Titan entered the fragrances segment with the brand Skinn, Leveraging precision engineering core competencies from watch making, Titan initiated TEAL (erstwhile PED) in 2005, catering to global majors across industry verticals like aerospace, automotive, oil & gas, engineering, hydraulics, solar and medical instruments. The Company's subsidiaries include Carat Lane, Favre Leuba AG and Titan Engineering and Automation Limited

Key lines of business

- **Jewellery:** Tanishq offers a premium range of gold jewellery studded with diamonds and precious, semi-precious stones in various hues in 18KT and a wide range of plain gold jewellery in 22KT pure gold. Platinum jewellery also forms part of the product range. The jewellery is manufactured in a fully

integrated manufacturing plant with state-of-the-art equipment. Zoya offers premium studded jewellery catering to the needs of the elite. In 2016, Titan acquired majority stake in online jewellery player Carat Lane.

- **Watches:** The four main watch brands include Titan for the mid-premium segment, Fastrack focused on the youth and trendy fashion space, Sonata for the mass market and Xyls for the premium market. The Titan brand architecture comprises several sub-brands, each of which is a market leader in own space. Notable among them are Titan Edge, Titan Raga, Nebula. The company manufactures over 15 million watches per annum and has a customer base of over 100 million. Helios, India's multi-brand watch retailer, offers designs across 30 international brands in addition to Titan brands.
- **Eye wear:** Titan Eyeplus, the third major line of consumer business from Titan Company Ltd, offers a variety of differentiated products to the end consumer consisting of frames, lenses, contact lenses and sunglasses. The Company's eyewear brands are retailed through Titan Eye Plus stores.

Income Statement (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues	129,789	161,198	198,467	236,412	279,992
Growth (%)	15.1%	24.2%	23.1%	19.1%	18.4%
COGS	95,382	118,071	145,281	172,821	204,399
Employee Expense	7,939	8,851	10,699	12,508	14,253
A&P Expense	4,630	4,940	5,954	7,092	8,400
S&D Expense	1,694	2,418	2,878	3,192	3,780
Rent Expense	1,954	2,418	2,779	3,073	3,640
Other Expenses	6,636	8,053	9,716	11,574	13,707
EBITDA	11,555	16,447	21,161	26,153	31,814
EBITDA Growth (%)	23.6%	42.3%	28.7%	23.6%	21.6%
EBITDA Margin (%)	8.9%	10.2%	10.7%	11.1%	11.4%
Depreciation	1,105	1,314	1,744	2,223	2,758
EBIT	10,450	15,133	19,418	23,930	29,056
Other Income (Including EO Items)	(322)	722	777	917	1,032
Interest	377	529	524	558	585
PBT	9,750	15,326	19,671	24,289	29,503
Total Tax	2,760	4,279	5,508	7,044	8,851
RPAT before associate earnings	6,991	11,047	14,163	17,245	20,652
Share of Associate earnings	(18)	(28)	(28)	(28)	(28)
RPAT	6,973	11,019	14,136	17,218	20,625
Exceptional Gain/(loss)	(1,027)	(167)	-	-	-
Adjusted PAT	8,000	11,186	14,136	17,218	20,625
APAT Growth (%)	18.6%	39.8%	26.4%	21.8%	19.8%
Adjusted EPS (Rs)	9.0	12.6	15.9	19.4	23.2

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	888	888	888	888	888
Reserves	41,436	50,011	60,185	72,048	85,176
Total Shareholders Funds	42,324	50,899	61,072	72,936	86,064
Minority Interest	264	(18)	(18)	(18)	(18)
Long Term Debt	-	-	-	-	-
Short Term Debt	26,066	23,349	27,828	33,364	39,803
Total Debt	26,066	23,349	27,828	33,364	39,803
Net Deferred Taxes	(861)	(1,351)	(1,351)	(1,351)	(1,351)
Other Non-current Liabilities & Provns	-	13	13	13	13
TOTAL SOURCES OF FUNDS	67,792	72,892	87,544	104,943	124,511
APPLICATION OF FUNDS					
Net Block	10,745	13,511	15,908	18,252	20,658
CWIP	1,432	430	430	430	430
Goodwill on Consolidation	1,230	1,230	1,230	1,230	1,230
Other Non-current Assets	949	1,083	1,083	1,083	1,083
Total Non-current Assets	14,356	16,255	18,652	20,995	23,402
Investments	370	344	344	344	344
Inventories	49,257	59,248	67,884	82,158	98,070
Debtors	2,076	2,957	4,186	5,634	7,439
Other Current Assets	5,428	8,860	9,256	10,830	12,826
Cash & Equivalents	11,727	6,195	9,352	11,019	13,267
Total Current Assets	68,488	77,261	90,678	109,640	131,602
Creditors	7,828	8,777	10,222	12,176	14,421
Other Current Liabilities & Provns	7,595	12,190	11,907	13,860	16,415
Total Current Liabilities	15,423	20,968	22,129	26,036	30,836
Net Current Assets	53,066	56,293	68,548	83,604	100,766
TOTAL APPLICATION OF FUNDS	67,792	72,892	87,544	104,943	124,511

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Reported PBT	9,750	15,492	19,671	24,289	29,503
Non-operating & EO Items	(420)	(1,083)	(805)	(944)	(1,060)
Interest Expenses	377	529	524	558	585
Depreciation	1,105	1,314	1,744	2,223	2,758
Working Capital Change	9,475	(8,758)	(9,099)	(13,389)	(14,915)
Tax Paid	(2,779)	(4,279)	(5,508)	(7,044)	(8,851)
OPERATING CASH FLOW (a)	17,509	3,216	6,527	5,692	8,020
Capex	(2,608)	(2,921)	(4,140)	(4,566)	(5,164)
Free Cash Flow (FCF)	14,901	295	2,387	1,126	2,856
Investments	(8,029)	3,947	-	-	-
Non-operating Income	408	78	777	917	1,032
INVESTING CASH FLOW (b)	(10,229)	1,105	(3,363)	(3,650)	(4,132)
Debt Issuance/(Repaid)	(1,243)	(2,717)	4,479	5,536	6,440
Interest Expenses	(377)	(529)	(524)	(558)	(585)
FCFE	13,281	(2,951)	6,342	6,105	8,711
Share Capital Issuance	-	-	-	-	-
Dividend	(36)	(2,784)	(3,962)	(5,354)	(7,496)
Others	-	99	0	(0)	(0)
FINANCING CASH FLOW (c)	(1,656)	(5,931)	(7)	(376)	(1,641)
NET CASH FLOW (a+b+c)	5,624	(1,610)	3,157	1,667	2,247
EO Items, Others	1,552	1,240	1,240	1,240	1,240
Closing Cash & Equivalents	7,789	6,179	9,336	11,003	13,250

Source: Company, HDFC sec Inst Research

Key Ratios

Year ending March	FY17	FY18	FY19E	FY20E	FY21E
PROFITABILITY (%)					
GPM	26.5	26.8	26.8	26.9	27.0
EBITDA Margin	8.9	10.2	10.7	11.1	11.4
EBIT Margin	8.1	9.4	9.8	10.1	10.4
APAT Margin	6.2	6.9	7.1	7.3	7.4
RoE	20.7	24.0	25.2	25.7	25.9
RoIC (or Core RoCE)	14.2	17.8	19.3	19.7	19.8
RoCE	13.5	16.4	18.1	18.3	18.3
EFFICIENCY					
Tax Rate (%)	25.6	27.6	28.0	29.0	30.0
Fixed Asset Turnover (x)	13.2	11.7	11.1	10.5	10.1
Inventory (days)	132	123	125	127	128
Debtors (days)	6	6	8	9	10
Other Current Assets (days)	15	20	17	17	17
Payables (days)	22	19	19	19	19
Other Current Liab&Provns (days)	21	28	22	21	21
Cash Conversion Cycle (days)	115	107	111	115	116
Net D/E (x)	0.3	0.3	0.3	0.3	0.3
Interest Coverage (x)	27.7	28.6	37.1	42.9	49.7
PER SHARE DATA (Rs)					
EPS	9.0	12.6	15.9	19.4	23.2
CEPS	10.3	14.1	17.9	21.9	26.3
Dividend	2.6	3.7	5.0	7.0	9.0
Book Value	47.7	57.3	68.8	82.2	96.9
VALUATION					
P/E (x)	99.5	71.2	56.3	46.3	38.6
P/BV (x)	18.8	15.6	13.0	10.9	9.3
EV/EBITDA (x)	70.2	49.5	38.5	31.3	25.9
EV/Revenues (x)	6.2	5.0	4.1	3.5	2.9
OCF/EV (%)	2.2	0.4	0.8	0.7	1.0
FCF/EV (%)	1.4	0.0	0.3	0.1	0.3
FCFE/Mkt Cap (%)	1.2	(0.4)	0.8	0.8	1.1
Dividend Yield (%)	0.3	0.4	0.6	0.8	1.0

Source: Company, HDFC sec Inst Research

INDUSTRY JEWELLERY RETAIL
CMP (as on 20 Jun 2018) Rs 449
Target Price Rs 650

Nifty 10,772

Sensex 35,547

KEY STOCK DATA

Bloomberg TJL IN

No. of Shares (mn) 14

MCap (Rs bn) / (\$ mn) 6/90

6m avg traded value (Rs mn) 8

STOCK PERFORMANCE (%)
52 Week high / low Rs 701/229

3M 6M 12M

Absolute (%) (9.6) (32.9) 84.7

Relative (%) (17.3) (38.1) 71.1

SHAREHOLDING PATTERN (%)

Promoters 66.4

FIs & Local MFs 6.8

FPIs -

Public & Others 26.7

Source : BSE

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Turnaround story

Thangamayil (TJL) is one of the leading tier-2 and 3 town-focused jewellers in Tamil Nadu. The past decade has been a roller coaster ride for TJL as it went from nearly doubling revenue/tripling profits every alternate year over FY08-13 to being arm-twisted by banks to liquidate un-hedged inventory and mitigate gold price risk in FY14-15. Gross margins shrunk to nearly a quarter (3.6% in FY15) of their decadal peak in FY12. Subsequent regulatory interventions and a stressed balance sheet didn't make a case for expansion either.

- However, given the current tailwinds in organized jewellery and a healing balance sheet, conditions seem apt for TJL to stage a turnaround. We expect TJL to deliver revenue/EBITDA/PAT CAGR of 18/24/31% over FY18-21 underpinned by 1. Network expansion, 2. Volume-led SSS growth, 3. Favourable product and gold sourcing mix.
- A classic turnaround story in the making, as the economic (RoIC-WACC) spread swings ~490bps to 4% (vs -0.9% currently). We initiate coverage with a BUY recommendation and target a DCF-based TP of Rs 650 (implies 22x FY20E EPS), over 50% discount to industry bellwether Titan.

Investment thesis

- **Getting down to brass tacks to stoke SSSG:** After a roller-coaster decade, Thangamayil is getting down to brass tacks and pulling multiple levers to stoke SSSG – 1. Widening the design portfolio at display by building additional floors in select stores, 2. Renovation of stores-- ~60% area in sq. ft. until FY18, (3) Volume

push led by product-specific melas and (4) increasingly leveraging its gold deposits scheme to gain share from the unorganized space. We expect the aforementioned levers to drive SSS retail growth (Est 17/13/13% for FY19/FY20/FY21E) largely underpinned by volumes.

- **Store expansion to resume via owned store route:** TJL remained on the fence since FY15 in terms of expansion as its balance sheet couldn't afford one. (added only 2 stores over FY15-18E). Regulatory challenges also warranted a cautious stance on expansion for a player of TJL's scale. However, a spate of pro-organized player regulations coupled with a healing balance sheet (Debt mix has improved, Net Debt/EBITDA has improved to 5.8x in FY18 vs ~87x in FY15), management feels confident to step up expansion plans. It intends to add ~4k sq. ft/year (~4 stores/annually) over FY18-20E. Bulk of the additions will be in tier-3 and 4 cities within Tamil Nadu via owned stores, where competitive intensity from big-box jewellers remains low.

Financial summary

YE Mar (Rs mn)	FY18	FY19E	FY20E	FY21E
Net Sales	13,793	16,554	19,457	22,708
EBITDA	593	763	935	1,126
APAT	229	288	406	510
Diluted EPS (Rs/sh)	16.7	21.0	29.6	37.1
P/E (x)	27.3	21.6	15.3	12.2
ROE (%)	14.4	16.0	19.5	20.9
RoIC (%)	7.9	9.4	11.9	12.4
ROCE (%)	7.6	8.2	9.1	9.5

Source: Company, HDFC sec Inst Research

- **Once bitten, twice shy; balance sheet getting healthier:** The arm-twisting by bankers in FY14-15 forced the management into liquidating its unhedged gold inventory. This in turn put a lot of stress on TJL's balance-sheet. The management has since been focused on increasingly procuring gold through low-cost naturally-hedged sources such as Gold-on-lease (GoL). Gold sourced through GoL has increased to 25% of Gold sales (volume) from a mere 2% in FY15.
- **Margins to inch up gradually:** 1. Room to increase making charges, 2. Thrust on higher-margin silver biz, 3. Savings from in-house manufacturing, 4. Improving studded jewellery mix are key levers which we believe could help in gross margin expansion. However, given the customer profile TJL caters to and increased competition from strong players such as GRT who intend to further penetrate in Tamil Nadu could restrict the quantum of margin expansion. We expect TJL's gross margin

to expand by 50bps to 9.4% by FY21E. Gross margin benefits coupled with SSSG growth to trickle down to operating margins too. We build in a ~80bps EBIT margin expansion to ~4.5% over FY18-21E, similar to its bigger south peers. Growth in PAT (31% CAGR over FY18-21E) is expected to be even more pronounced as increased use of low cost gold on lease would keep interest expense in check.

- **In the midst of a turnaround; initiate coverage with a BUY:** The cocktail of sector tailwinds and healthier balance sheet to carry out its initiatives on both – store additions and SSSG growth is expected to help TJL in its long overdue turnaround. We find comfort in TJL's valuation (16x FY20 EPS) especially given 1. the expected earnings growth (31% CAGR), 2. the sharp swing expected in economic spread (~490bps) over FY18-21E We initiate coverage with a BUY reco and DCF-based target price of Rs 650 (implying 22x FY20 EPS).

Getting down to brass tacks to stoke SSSG

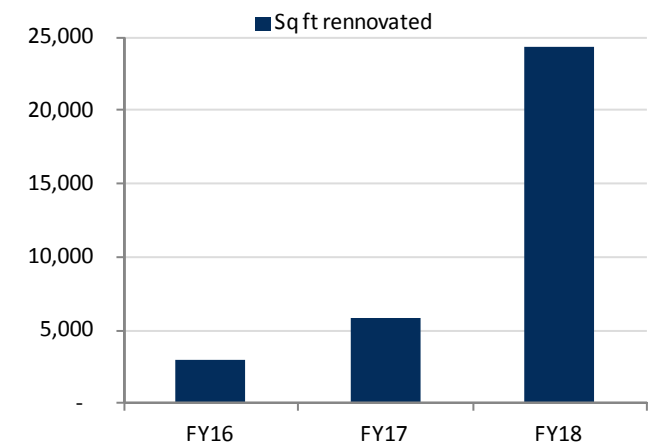
- **TJL is getting down to brass tacks to stoke SSSG –**
 1. Widening the design portfolio on display by building additional floors in select stores,
 2. Renovation of stores,
 3. Volume push led by product-specific melas and
 4. increasingly leveraging its gold deposits scheme to gain share from the unorganized space.
- **SSSG expected to clock 17/13% in FY19/FY20) largely underpinned by volumes.**
- **Product-specific melas aid in grabbing footfalls:** TJL sporadically during the year conducts product-specific melas such as Bangle Mela, Chain Mela, etc. It started this practice in Oct-17 in tier2 & 3 towns. Typically, TJL keeps inventory (specific product) equivalent to that of the entire store and hence the sheer breadth and width of designs pulls consumers into the store as **A**. There is very limited competition from top jewellers in tier 2 & 3 towns, **B**. Unorganized players find themselves inadequate to compete with the variety on offer. Any unsold inventory is then sold in the next city where the mela is organized.

[Chain mela TVC: \(Click on link\)](#)



- **Rejuvenating brand image via store renovations:** Given the cautious stance on expansion, TJL’s management decided to renovate stores to fix the problem of declining SSSG. This has helped TJL attract new consumers and improve SSSG too. This is evident in the SSSG jump for the retail biz in FY18 (~19% YoY). The new brand image aids in pushing making charge hikes to consumers too. Renovation is being done at half the cost of store addition (~Rs 2500 per sq ft). The company has already refurbished ~34k sq ft (i.e., ~58% of its retail footprint) at the end of FY18 and intends to renovate the rest by Sept-2018.

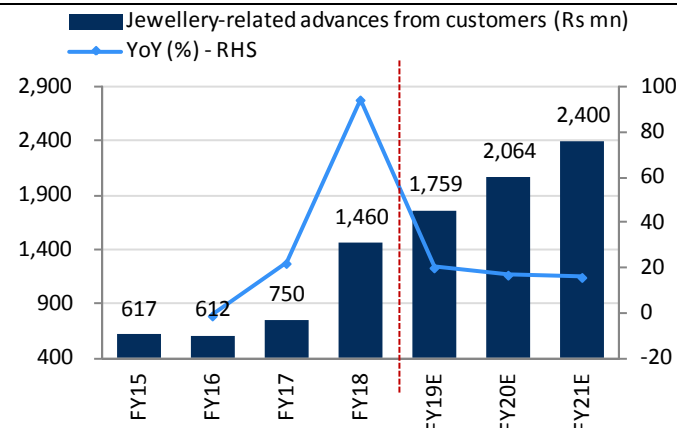
Estimated space renovated (Sq ft)



Source: Company, HDFC sec Inst Research

- Expanding shelf creatively:** TJL has tied up with the landlord of select stores (In tier 2 towns) to construct additional floors in select stores. Arrangement is such that the capex for construction of the additional floors is borne by the respective landlords, while incremental rent is borne by TJL. We believe this creative expansion of shelf and consequently wider range/collection to choose from will improve TJL's SSSG. FY18's SSSG spurt is a case in point (19%).
- Probable axe on unregulated deposits – Advantage Thangamayil:** Gold deposit schemes typically are great up-selling tools for jewellers. (A consumer typically spends 1.4-1.7x the accumulated deposits). TJL is estimated to have garnered ~18-20% of its revenue from its gold-deposit scheme in FY18 (similar to that of Tanishq), the management intends to put more thrust on this tool to build consumer stickiness and increase SSSG. Given the limited presence of the SUPERPACK in TJL's geography of presence currently (Refer to – [Where will the expansion come from?](#)) We expect this tool to be a "Hero product" in tier 3/4 cities/towns for TJL as the govt. is expected to clamp down on unregulated deposits of unorganized jewellers.

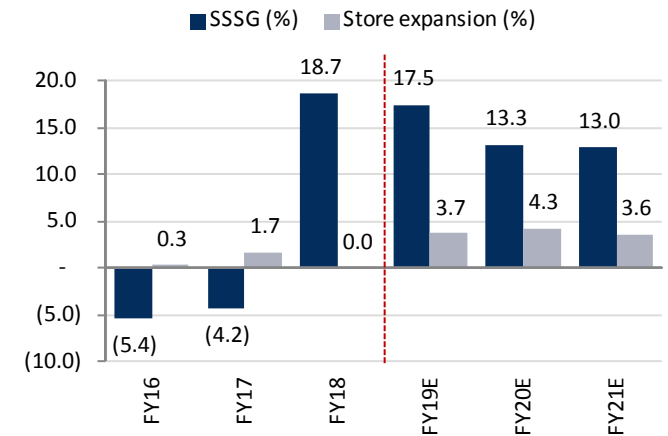
Jewellery scheme-led advances to grow at 18% CAGR over FY18-21E



Source: Bloomberg, HDFC sec Inst Research

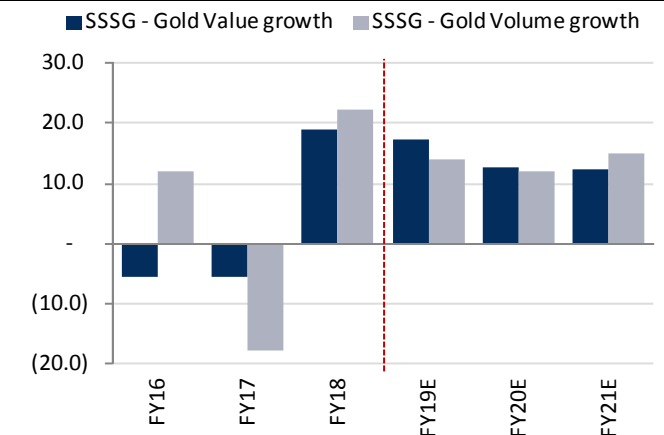
- Expect ~17/13% SSSG in FY19/FY20E:** The aforementioned levers are expected to rev up TJL's SSSG and drive bulk of the growth over the next three years. We expect ~17/13% SSSG in FY19 & FY20 respectively.

SSSG to drive bulk of the growth



Source: Company, HDFC sec Inst Research

... TJL's mainstay (Gold ornaments) to do well



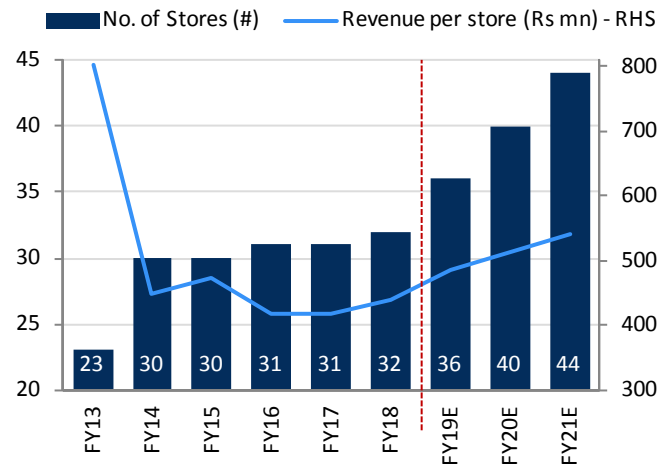
Source: Company, HDFC sec Inst Research

Store expansion to resume via owned store route

- After being forced to sit on the fences since FY15, Thangamayil finally intends to resume its expansion drive and intends to add 4-5 stores and ~4-5k sq. ft/yr.
- Bulk of the additions will be in Tier 3 and 4 towns where presence of the rest of the SUPERPACK is limited. 12/32 TJL stores are in cities/districts with per capita income below the state average.
- Top market Chennai remains elusive in TJL's store portfolio.
- **Store expansion to resume via owned store route:** TJL remained on the fences since FY15 in terms of expansion as its balance sheet couldn't afford expansion. (Just added 2 stores over FY15-18E). Regulatory challenges also warranted a cautious

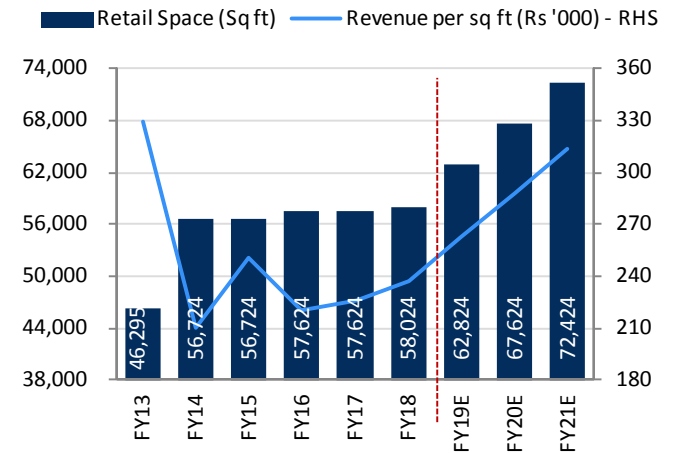
stance on expansion for a player of TJL's scale. A spate of pro-organized player regulations coupled with a healing balance sheet gives management the confidence to resume a cautious expansion drive. It intends to add ~4-5k sq. ft/year (~4-5 stores/annually) over FY18-20E. (Note: Net debt/equity has remained unchanged over the last 3 years, debt mix has improved led by use of low cost gold on lease facility). Net Debt/EBITDA has improved to 5.8x in FY18 vs ~87x in FY15. Bulk of the store additions will be in tier-3 and 4 cities within Tamil Nadu, where competitive intensity from big-box jewellers remains limited and expansion will be via owned stores. No franchisees for TJL currently as management concedes the brand isn't ready for it.

TJL to add 4 stores annually



Source: Company, HDFC sec Inst Research

...~4-5k sq ft per year

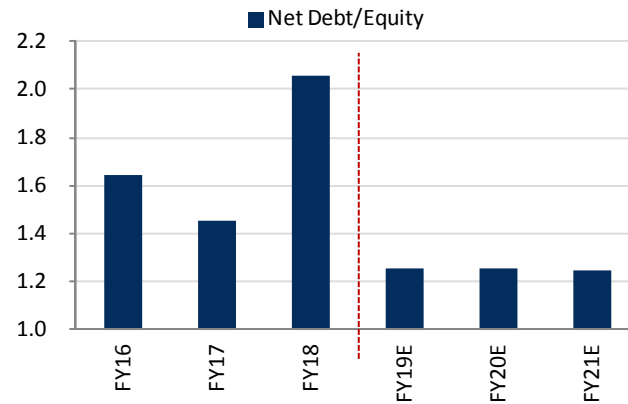


Source: Company, HDFC sec Inst Research

- **Sufficiently funded for expansion ambitions:** We believe a throughput of ~3-5kg gold/day/new store could easily be handled with an investment of ~Rs 450-500mn per year (incl. a capex of ~Rs 20-

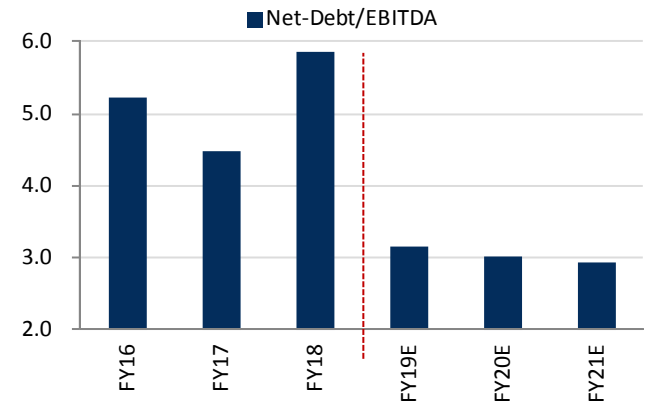
30mn). Hence, TJL's cautious network expansion ambitions can easily be funded given the expected improvement in leverage.

TJL: Net Debt/Equity



Source: Company, HDFC sec Inst Research

TJL: Net Debt/EBITDA

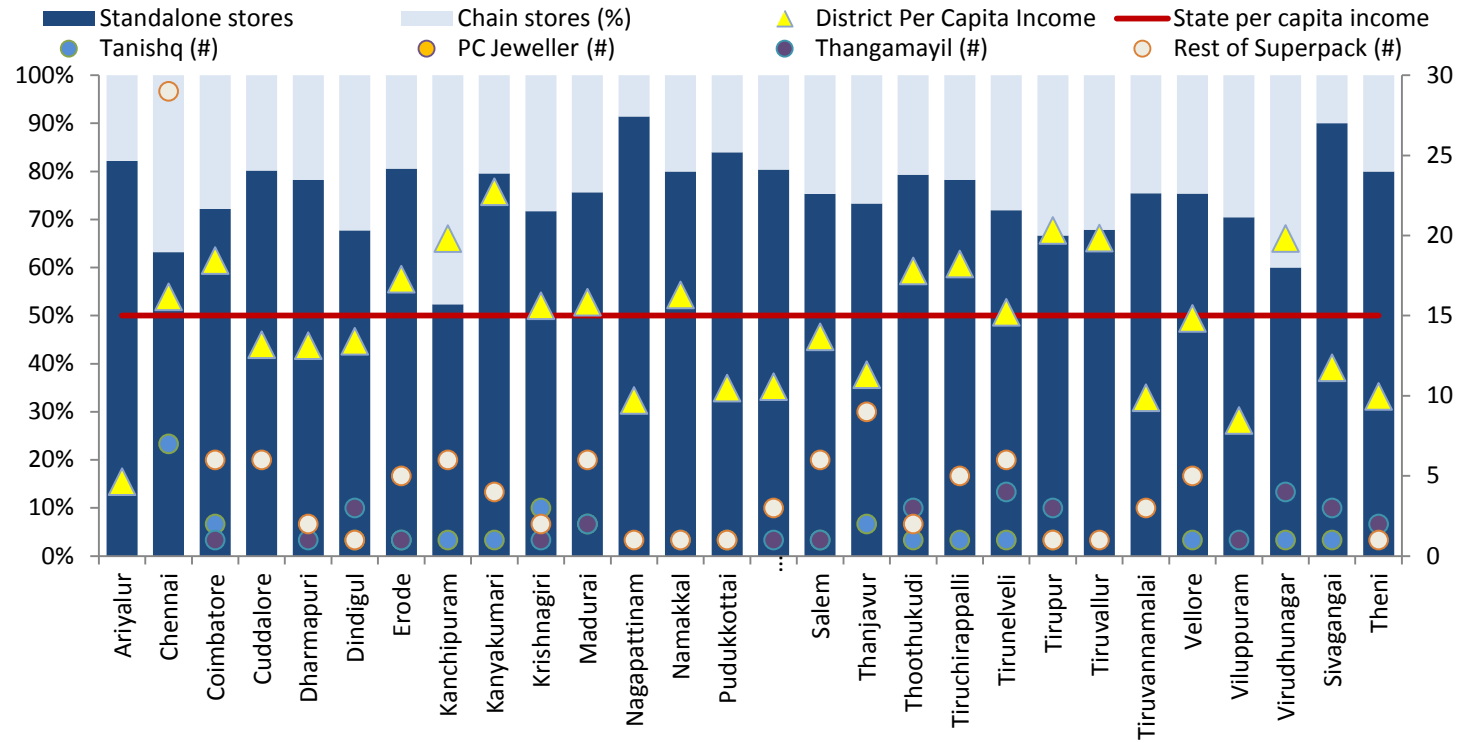


Source: Company, HDFC sec Inst Research

- Where could the expansion come from? While TJL for the next two years intends to focus on Tier 2/3/4 towns (12/32 TJL stores are in districts with per capita income below the state avg) for expansion. We believe the scope for expansion for

TJL is present even in districts with higher than avg. state per capita income for TN. Also the Chennai market which is estimated to be a ~Rs 600-650bn market remains elusive in TJL's store portfolio.

Inspite of a strong presence of SUPERPACK; TN presents ample expansion potential



Source: Bloomberg, HDFC sec Inst Research

In order to assess the expansion potential for TJL; we have cut the TN market into 28 districts which have >20 BIS listed stores each wherein the superpack's share in the chain stores </=10%

Further, we have placed a necessary condition (Thangamayil's store share should be </= 20% of chain stores) for districts with per capita income greater than state avg.

For Districts with per capita income </= state avg; (Thangamayil's store share should be </= 15% of chain stores)

The highlighted states give an inkling of the expansion potential

Note Chennai is an exception and Thangamayil will at some point need to contemplate having a presence in the city.

TJL's expansion Potential

Districts	Per Capita Income (Rs)	TJL stores	Standalone stores	Chain stores	Superpack Stores	TJL % of chain stores	Superpack % of chain stores
Kanyakumari	16,559		70	18	5	-	5.6
Tirupur	57,706	3	26	13	5	21.4	12.5
Tiruvallur	65,781		19	9	1	-	3.6
Virudhunagar	47,042	4	18	12	5	30.8	16.1
Kanchipuram	46,828		33	30	7	-	10.9
Coimbatore	47,812	1	91	35	9	2.7	7.0
Tiruchirappalli	61,631		36	10	6	-	12.8
Thoothukudi	70,667	3	46	12	6	23.1	10.2
Erode	81,094	1	54	13	7	7.1	10.3
Namakkal	55,719	1	24	6	2	16.7	6.7
Chennai	56,506		141	82	36	-	15.7
Madurai	34,640	2	59	19	10	9.5	12.5
Krishnagiri	58,133	1	33	13	6	6.3	12.2
Tirunelveli	37,390	4	64	25	11	15.4	12.2
Vellore	37,707		49	16	6	-	9.1
Salem	48,802	1	58	19	8	5.0	10.3
Dindigul	40,366	3	21	10	5	27.3	15.6
Cuddalore	63,467		85	21	6	-	5.7
Dharmapuri	65,011	1	18	5	3	20.0	13.0
Sivagangai	54,259	3	9	4	4	60.0	28.6
Thanjavur	72,479		33	12	11	-	23.4
Ramanathapuram	70,778	1	45	11	4	9.1	7.1
Pudukkottai	35,241		21	4	2	-	7.7
Theni	52,900	2	16	4	3	50.0	15.0
Tiruvannamalai	30,181		43	14	3	-	5.3
Nagapattinam	70,689		32	3	1	-	2.9
Viluppuram	41,912	1	43	18	1	5.6	1.6
Ariyalur	35,539		23	5	0	-	-

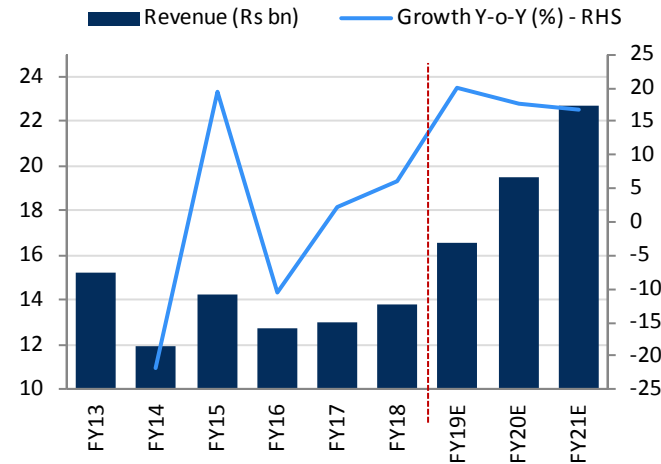
Source: Department of Statistics and Economics, Company, BIS, HDFC Sec Inst Research

Top-line to gain steam; margins to inch up gradually:

- Expect SSSG-led revenue growth of 18% CAGR: Given the thrust on SSSG, we expect revenue to

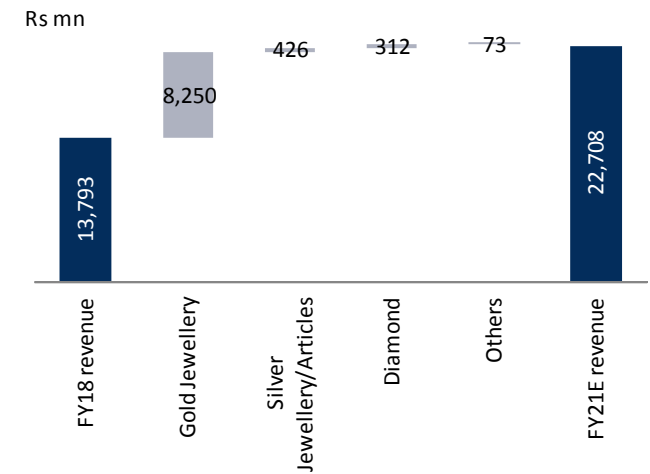
grow at a CAGR of 18% over FY18-21E. We build in SSSG of ~17/13/13% in FY19/FY20/FY21E.

Revenue to grow at 18% CAGR over FY18-21E



Source: Company, HDFC sec Inst Research

Gold to contribute bulk of the incremental top-line



Source: Company, HDFC sec Inst Research

- Multiple margin levers to pull:
 - Lever 1: Room to increase making charges:** The hand-twisting by bankers led TJL to sell its unhedged inventory at throw-away prices to repay lenders. This can be seen in the below table wherein Gross margins dropped to 6.5% in FY14 (vs 10.7% in FY13) and the company barely broke-even at the operational level.
 - Lever 2: Thrust on higher-margin silver & studded biz:** Management intends to put impetus on the higher margin silver jewellery (gross margin: 15.6% in FY18) and silver articles and studded jewellery (~9% in FY18). While the

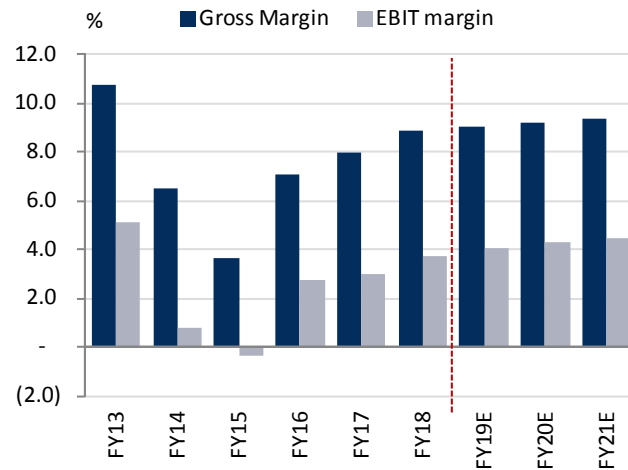
management is confident of increasing its diamond share to 5% of sales, we take a cautious stance on this one, as the nature of the beast (read: TN consumer buying behavior) and TJL's tier 3/4 customer profile doesn't allow us to build an upbeat forecast on studded jewellery. An inkling can be seen in GRT's (one of the most efficient jewellers in India) studded ratio.

- Lever 3: Savings from in-house manufacturing:** TJL intends to increase its in-house manufacturing to ~55-60% by FY20, this could usher in savings of ~2-3% on making charges

- **...increasing competitive intensity could blunt the pace of margin expansion:** Given the customer profile TJL caters to and increased competition from strong players such as GRT who intend to further penetrate in Tamil Nadu could restrict the quantum of margin expansion. We expect TJL’s gross margin to expand by 50bps to 9.4% by FY20E. Modest gross margin benefits coupled with SSSG-led operating leverage is expected to trickle down to operating

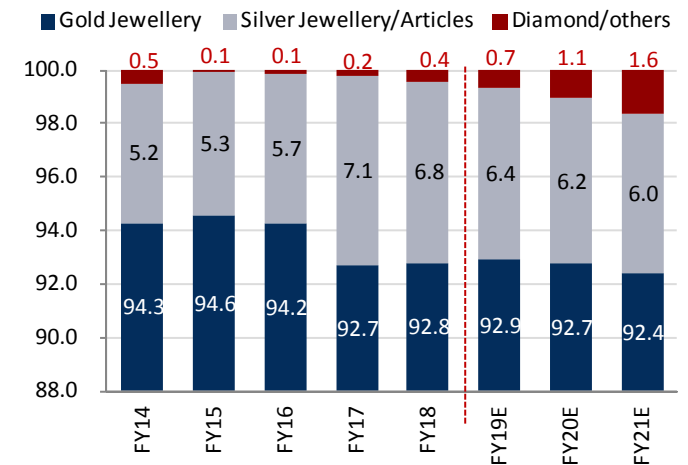
- We build in a ~80bps EBIT margin expansion to ~4.5%, similar to that of its bigger south peers. Growth in PAT (33% CAGR over FY18-20E) is expected to be even more pronounced as increased use of low-cost gold on lease would keep interest expense growth in check.

...Margins to inch up gradually



Source: Company, HDFC sec Inst Research

TJL’s Revenue Mix



Source: Company, HDFC sec Inst Research

- **TMJL Plus Stores to aid in pushing silver jewellery/articles sales:** These are typically small 150-200 sq ft stores which TJL intends to use to push silver throughput.

Mix of jewellery procurement (%)

Own manufacturing	30
Job Work (Metal Provided)	40
Direct Purchase	30

Source: Company, HDFC sec Inst Research

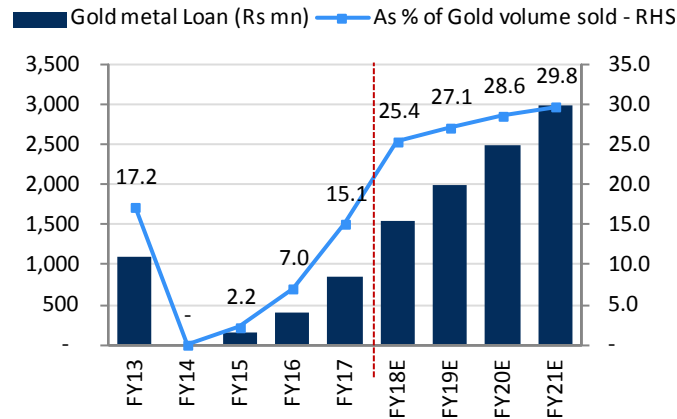


Once bitten, twice shy; balance sheet getting healthier

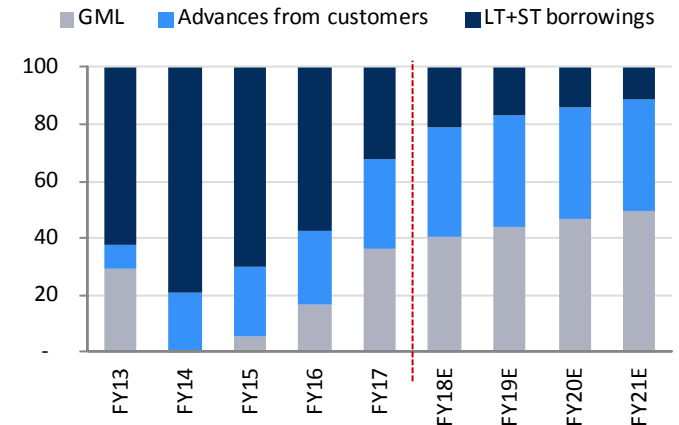
- Once bitten, twice shy; balance sheet getting healthier:** The hand-twisting by bankers in FY14-15 by forcing the management into liquidate its un-hedged gold inventory to mitigate gold price risk put a lot of stress on TJL's financials. This can be seen in the double whammy of 1. EBIT shrinking, 2. Interest increasing, hence interest coverage ratio deteriorated significantly during this period. The management has since been focused on

increasingly procuring gold through low cost hedging sources such as Gold-on-lease (GoL). Gold sourced through GoL has increased to 25% of Gold sales (volume) from a mere 2% in FY15. This will help improve the interest cover profile for the company and the positive impact on bottom-line will be more pronounced vs the EBIT growth over the next three years.

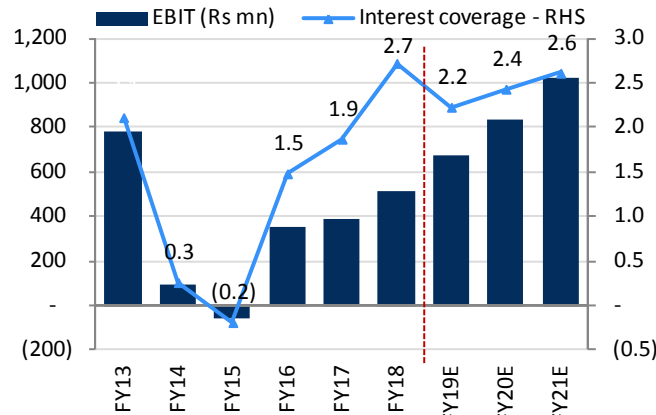
GML as % of total gold volume sold increasing



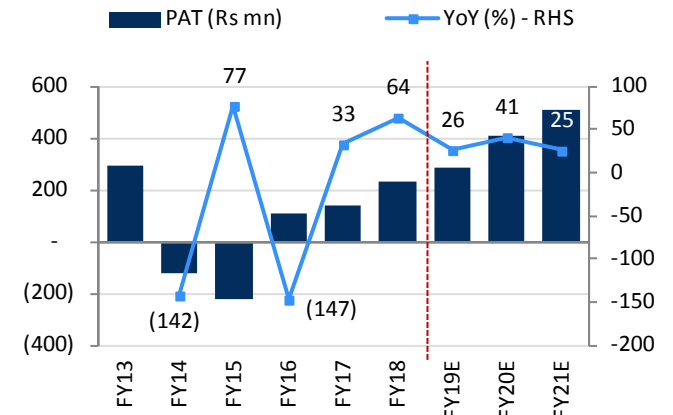
...Debt mix improving



Interest cover improving



...31% PAT CAGR expected over FY18-21E



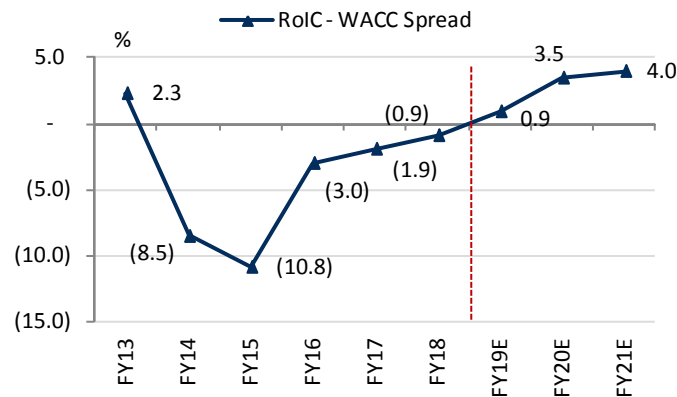
Source: Company, HDFC sec Inst Research

Source: Company, HDFC sec Inst Research

In the midst of a turnaround

- TJL's story is primarily about its economic spread (RoIC - WACC) improving.
- While sales velocity and margins are expected to contribute the bulk of this ~490bps improvement in spread. In the long-run, working capital efficiency will be the key enabler as profitability improvement is capped given the 1. customer profile (Tier 2/3/4 markets), 2. Consumer purchasing behavior of TN market, (predominant plain gold jewellery buyers), lack of presence in Chennai.

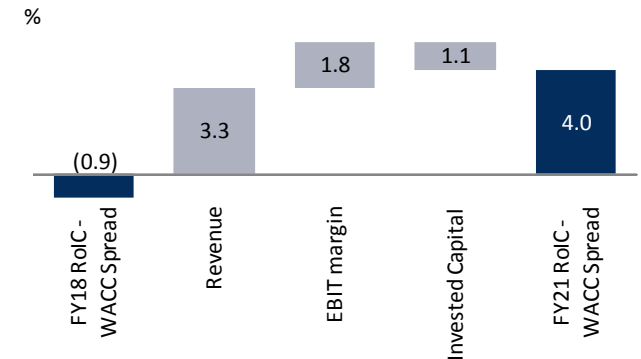
Economic spread to improve significantly



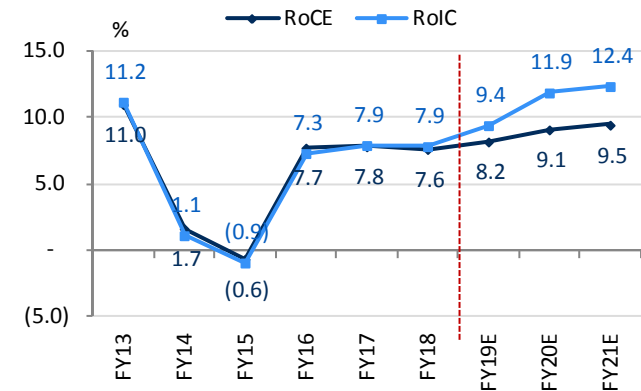
Source: Company, HDFC sec Inst Research

- **Additional stores to keep inventory days elevated:** TJL's inventory turns deteriorated in FY18 led by the re-launching of 14 stores which typically requires additional inventory stock to be placed in stores. Given the store additions planned, we expect inventory days to marginally inch up.

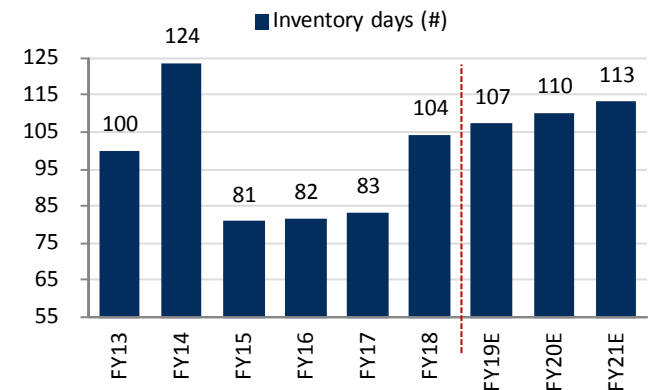
...contributors to economic spread



TJL: Return Profile



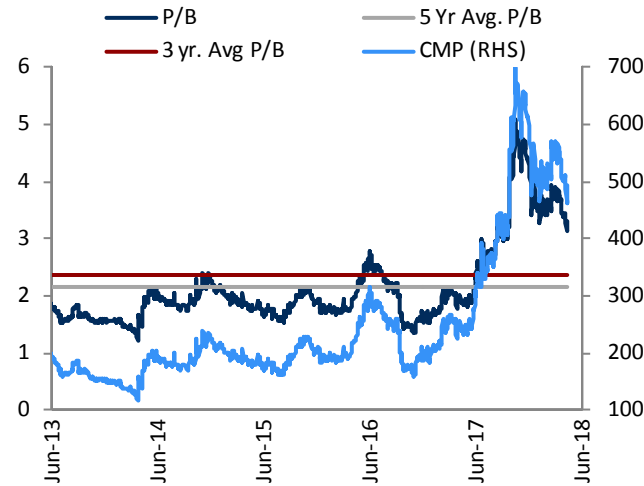
Inventory levels to marginally inch up



Source: Company, HDFC sec Inst Research

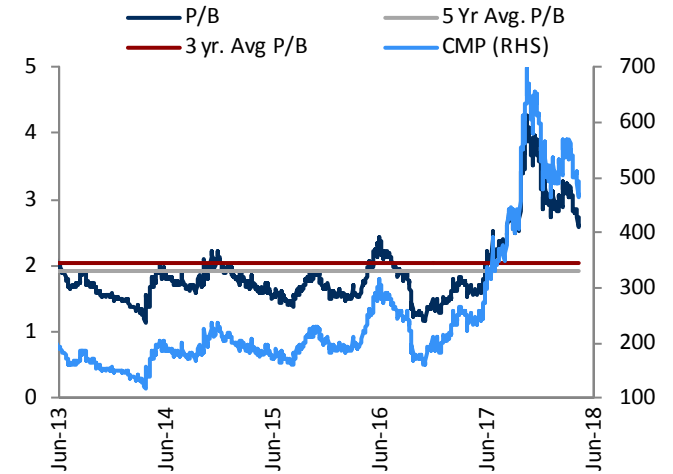
Valuation

1-year forward P/B band



Source: Bloomberg, HDFC sec Inst Research

2-year forward P/B band



Source: Bloomberg, HDFC sec Inst Research

- **3-stage DCF-based TP of Rs 650/sh; recommend BUY:** We expect TJL to deliver a revenue/EBITDA/PAT CAGR of 18/24/31% respectively over FY18-21E led by SSSG led spurt in revenue, operating and financial leverage (led by increased use of low-cost gold on lease arrangement with banks). Our DCF-based TP of Rs 650/sh, implies a P/E of 22x FY20 earnings & over 50% discount to Titan.
- **Stage 1 (FY18-21E):** Revenue/EBITDA/PAT grow at 18/24/31% respectively. We expect RoIC to improve to 12.4% in FY21 from 7.9% in FY18. **Stage 2 (FY21-**

30E): Revenue/EBITDA/PAT grow at 11/12/13% respectively. We expect RoIC to improve to 13.2% in FY30 from 12.4% in FY21. **Stage 3 (Terminal stage):** We expect a terminal growth rate of 5%.

- Our DCF assumes a WACC of 8.6% - assumes 1. Ke of 16.6% (> Titan) given the scale of the biz and sensitivity of value on working capital efficiency and profitability. 2. Post-tax cost of debt of 5.2% (Note. We treat GML and advances from customers as debt and hence, the effective rate is low).

DCF

(Rs mn)	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E
Revenue (Rs mn)	19,457	22,708	26,332	30,240	33,639	37,401	41,239	45,063	49,217	53,237	57,591
YoY	17.5	16.7	16.0	14.8	11.2	11.2	10.3	9.3	9.2	8.2	8.2
No. of stores (#)	36	40	44	48	52	56	60	64	68	72	76
YoY	12.5	11.1	10.0	9.1	8.3	7.7	7.1	6.7	6.3	5.9	5.6
SSSG (%) - Value	13.3	13.0	12.7	12.0	8.5	8.7	8.0	7.1	7.2	6.3	6.4
EBIT*(1-t)	561	683	824	961	1,071	1,205	1,329	1,467	1,602	1,750	1,910
Depreciation	99	106	115	125	137	149	164	179	196	214	234
Capex	(88)	(114)	(132)	(151)	(168)	(187)	(206)	(225)	(246)	(266)	(288)
Changes in WC (Winv)	(747)	(871)	(1,009)	(1,135)	(1,057)	(1,016)	(829)	(805)	(929)	(887)	(1,033)
FCFF	(175)	(195)	(202)	(200)	(18)	151	458	616	623	811	824
YoY (%)	(113.7)	11.4	3.4	(0.8)	(91.1)	(951.0)	202.1	34.6	1.1	30.2	1.6
Interest (1-t)	(230)	(262)	(296)	(333)	(369)	(405)	(444)	(484)	(525)	(567)	(610)
Net Borrowings	765	823	926	951	791	927	933	925	1,008	978	1,057
FCFE	359	367	428	418	404	674	946	1,057	1,107	1,223	1,271
Period No.	-	1	2	3	4	5	6	7	8	9	10
PV (FCFF)	(175)	(180)	(171)	(156)	(13)	100	279	345	322	385	360
Terminal Value											23,911
Net Debt (Mar-20E)	2820										
PV-Explicit Period	1273										
PV-Terminal Value	10462										
Equity Value (Rs mn)	8914										
Equity value per share (INR)	650										
FY20 Implied P/E (x)	21.9										
Terminal growth rate (%)	5.0%										
WACC	8.6%										
Terminal FCF multiple (x)	29.0										
No. of shares (mn)	13.7										
CMP	461										
Upside/(Downside)	40.9%										

Source: Company, HDFC sec Inst Research

Key Personnel (Thangamayil)

Name	Designation	Description
Balarama Govinda Das	Managing Director	He is a founder member has been driving the business of manufacturing and trading gold, silver and diamond jewellery for more than 30 years. Under his leadership, Thangamayil Jewellery turned into a public limited company.
Ba. Ramesh	Joint Managing Director	He is a founder member. He entered the family business at his young age to handle gems and jewellery trading. He brought about the concept of competitive pricing of certain key products in the gold industry when rest of South India was working on a concept of comparative pricing (prevailing market prices)
N.B.Kumar	Joint Managing Director	A founder member and entered the family business of trading gems and jewellery in the early eighties and has been managing the day-to-day affairs of the Company with a specific focus on human resource planning and development.
B. Rajesh Kanna	Chief Financial Officer	He holds a Diploma in Gemology. He joined Thangamayil Jewellery in 2008. He served as General Manager of Thangamayil Jewellery Limited.

Source: Company, HDFC sec Inst Research

Name	Description
Volatility in gold prices	Any material fluctuations in gold, silver and diamond prices might affect the profitability of the company.
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.
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.
Aggressive expansion by competitors:	Many south-based jewellers such as Kalyan Jewellers, Malabar Gold, and Joyalukkas, GRT may want to strengthen their hold down south and since this is a low-hanging fruit for most of them, TJL may face some competition in Tier 2/3/4 towns where they are present.
Maintaining and developing the brand	Brand is crucial factor for the success in the jewellery business. Any negative publicity with respect to business could adversely impact the company's business, results of operations and financial condition.

Source: Company, HDFC sec Inst Research

Company Profile: Thangamayil

- Thangamayil Jewellery Limited (TMJL), is one of the leading 2 & 3 city-focused jewellers in Tamil Nadu.
- Thangamayil was originally established in 1947 as Balu Jewellery in Madurai. It became a private limited company in 2000. In 2010, Thangamayil Jewellery held its initial public offering (IPO).
- Thangamayil Jewellery primarily sells gold, silver, diamonds and platinum jewellery. The company's

flagship store is located in Madurai and is selling jewellery with BIS hallmarking license since 2001. The company sources its jewellery from other Indian states such as Andhra Pradesh, Gujarat, Kerala and West Bengal. The company has a total of 58,000 square feet in area, across all its 32 showrooms.

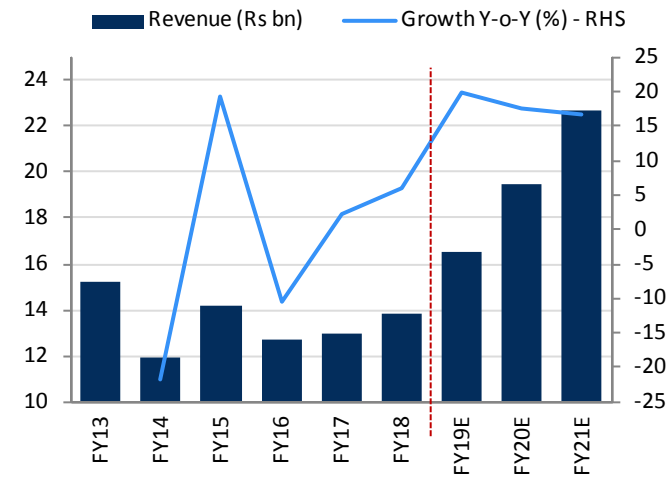


Source: Company



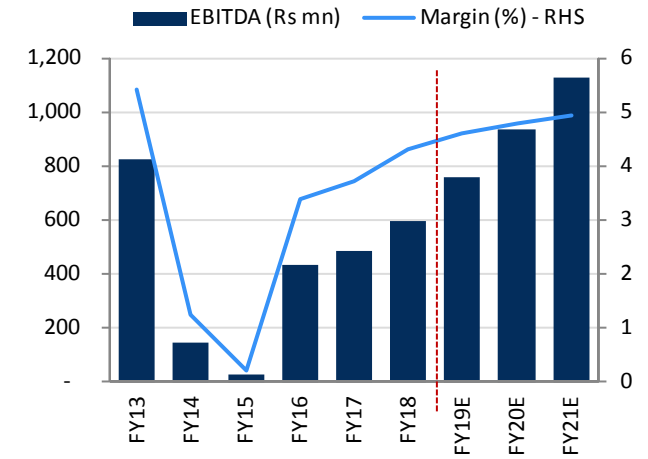
Story in Charts

Revenue to grow at 18% CAGR over FY18-21E



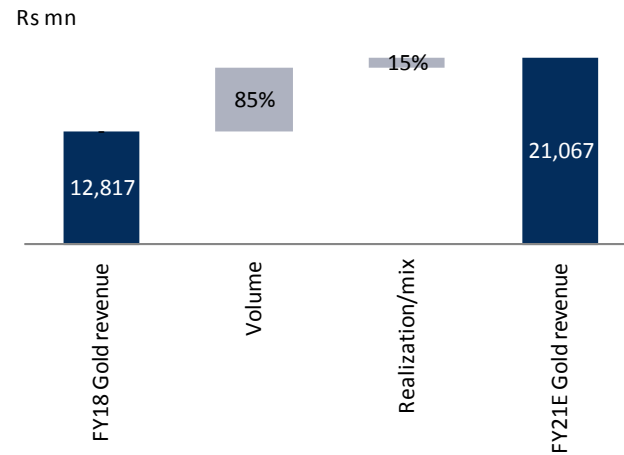
Source: Company, HDFC sec Inst Research

EBITDA; EBITDA margin



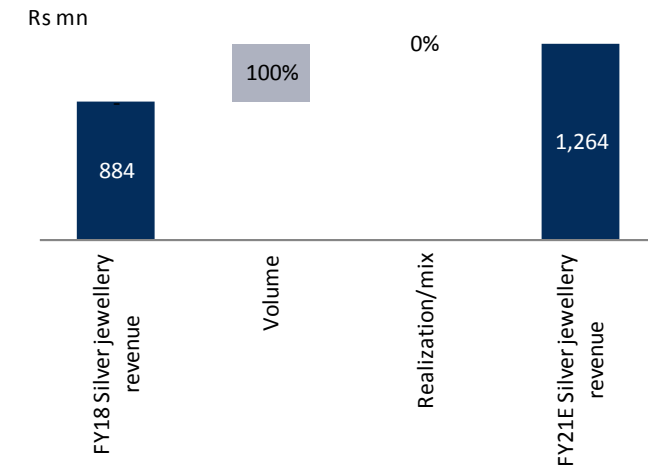
Source: Company, HDFC sec Inst Research

Volume to contribute lion's share of growth



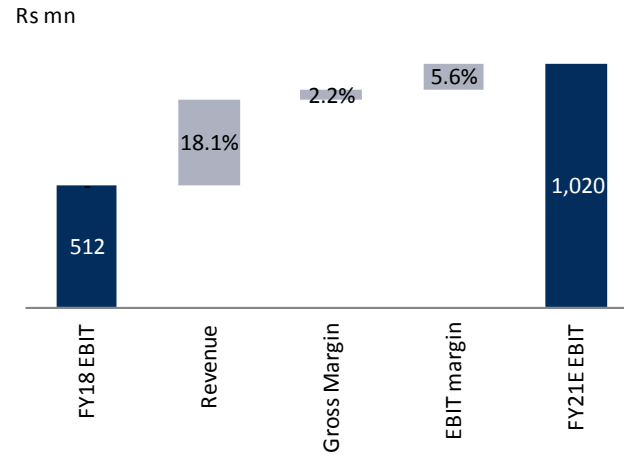
Source: Company, HDFC sec Inst Research

...Ditto for Silver



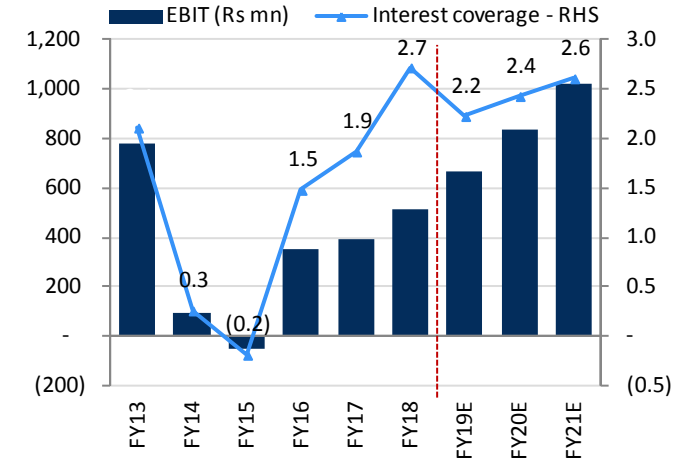
Source: Company, HDFC sec Inst Research

EBIT to double over FY18-21E



Source: Company, HDFC sec Inst Research

...Interest cover to expand



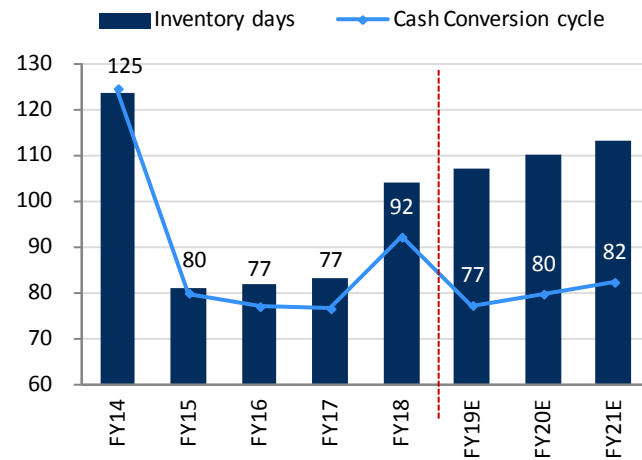
Source: Company, HDFC sec Inst Research

Du Pont Analysis

	FY16	FY17	FY18	FY19E	FY20E	FY21E
PAT margin (%)	0.8	1.1	1.7	1.7	2.1	2.2
Sales/Assets (x)	3.5	3.5	3.0	2.8	2.8	2.8
Equity Multiplier (x)	2.7	2.6	2.9	3.3	3.4	3.3

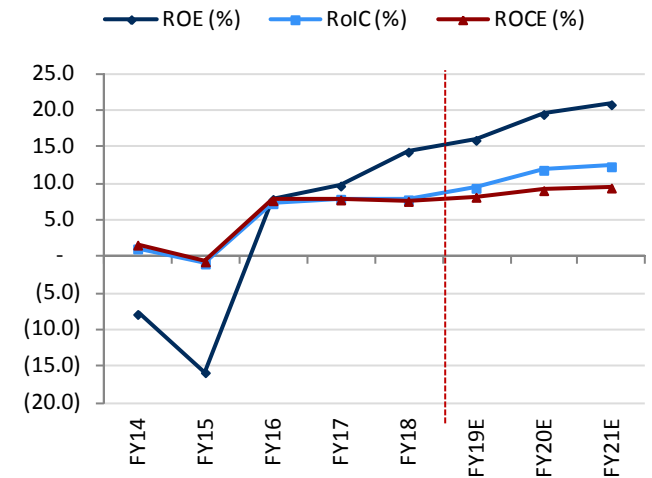
Source: Company, HDFC sec Inst Research

Cash conversion cycle to gradually inch up



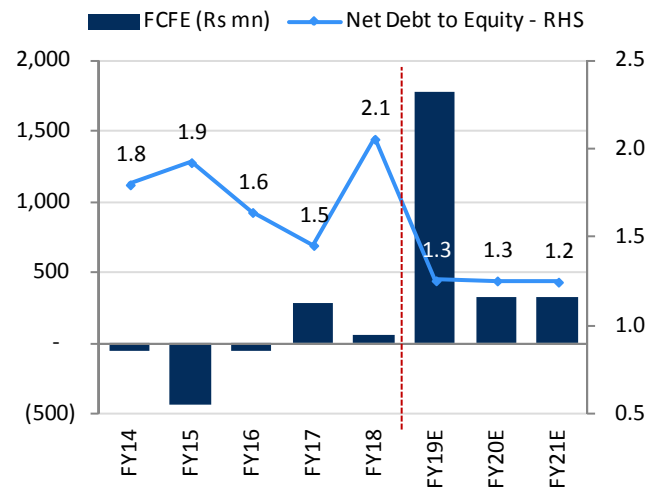
Source: Company, HDFC sec Inst Research

Thangamayil – Return Profile



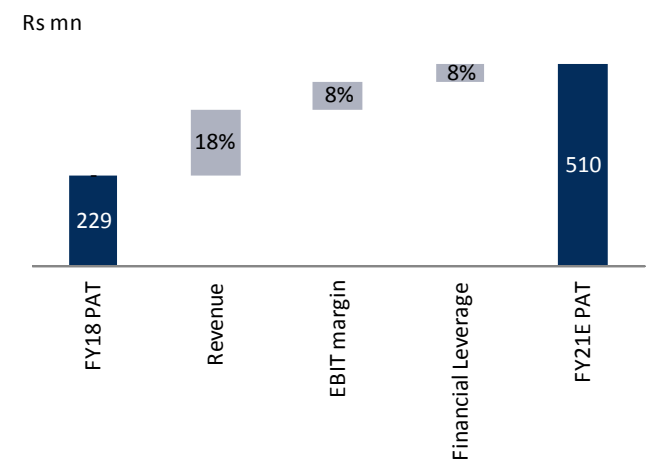
Source: Company, HDFC sec Inst Research

Free Cash Flow and D/E



Source: Company, HDFC sec Inst Research

Sales velocity to contribute bulk of PAT growth



Source: Company, HDFC sec Inst Research

Income Statement (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Net Revenues	12,995	13,793	16,554	19,457	22,708
Growth (%)	2.2%	6.1%	20.0%	17.5%	16.7%
COGS	11,959	12,568	15,051	17,660	20,577
Employee Expense	263	320	375	441	515
A&P Expense	107	113	136	160	187
Rent Expense	37	39	47	55	65
Other Expenses	145	159	182	204	238
EBITDA	484	593	763	935	1,126
EBITDA Growth (%)	12.1	22.5	28.5	22.6	20.4
EBITDA Margin (%)	3.7	4.3	4.6	4.8	5.0
Depreciation	94	82	93	99	106
EBIT	390	512	670	837	1,020
Other Income (Including EO Items)	11	16	60	114	131
Interest	208	188	300	344	390
PBT	193	339	430	607	761
Total Tax	53	111	142	200	251
RPAT	140	229	288	406	510
Exceptional Gain/(loss)	-	-	-	-	-
Adjusted PAT	140	229	288	406	510
APAT Growth (%)	32.7	63.7	26.0	41.0	25.4
Adjusted EPS (Rs)	10.2	16.7	21.0	29.6	37.1

Source: Company, HDFC sec Inst Research

Balance Sheet (Consolidated)

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
SOURCES OF FUNDS					
Share Capital - Equity	137	137	137	137	137
Reserves	1,356	1,550	1,780	2,107	2,504
Total Shareholders Funds	1,493	1,687	1,918	2,244	2,642
Long Term Debt	356	306	256	206	156
Short Term Debt	2,022	3,483	4,253	5,067	5,941
Total Debt	2,378	3,789	4,509	5,274	6,097
Net Deferred Taxes	(55)	16	16	16	16
Other Non-current Liabilities & Provns	-	-	-	-	-
TOTAL SOURCES OF FUNDS	3,816	5,492	6,443	7,534	8,755
APPLICATION OF FUNDS					
Net Block	723	742	732	721	728
CWIP	7	9	9	9	9
Other Non-current Assets	105	98	98	98	98
Total Non-current Assets	836	848	838	827	835
Inventories	3,120	4,759	4,864	5,877	7,046
Debtors	9	13	13	15	18
Other Current Assets	146	167	168	170	172
Cash & Equivalents	202	319	2,098	2,454	2,796
Total Current Assets	3,476	5,258	7,144	8,516	10,031
Creditors	271	234	303	356	416
Other Current Liabilities & Provns	225	380	1,236	1,453	1,696
Total Current Liabilities	496	614	1,539	1,809	2,111
Net Current Assets	2,981	4,644	5,604	6,707	7,920
TOTAL APPLICATION OF FUNDS	3,816	5,492	6,443	7,534	8,755

Source: Company, HDFC sec Inst Research

Cash Flow

Year ending March (Rs mn)	FY17	FY18	FY19E	FY20E	FY21E
Reported PBT	193	339	430	607	761
Non-operating & EO Items	1	(17)	(60)	(114)	(131)
Interest Expenses	208	188	300	344	390
Depreciation	94	82	93	99	106
Working Capital Change	206	(1,546)	819	(747)	(871)
Tax Paid	(61)	(111)	(142)	(200)	(251)
OPERATING CASH FLOW (a)	642	(1,065)	1,439	(12)	4
Capex	(38)	(102)	(83)	(88)	(114)
<i>Free Cash Flow (FCF)</i>	<i>604</i>	<i>(1,167)</i>	<i>1,357</i>	<i>(99)</i>	<i>(109)</i>
Investments	-	-	-	-	-
Non-operating Income	-	78	60	114	131
INVESTING CASH FLOW (b)	(38)	(24)	(22)	26	18
Debt Issuance/(Repaid)	(320)	1,223	420	421	433
<i>FCFE</i>	<i>284</i>	<i>56</i>	<i>1,777</i>	<i>322</i>	<i>324</i>
Share Capital Issuance	-	-	-	-	-
Dividend	(17)	(33)	(58)	(80)	(112)
Others	(159)	16	-	-	-
FINANCING CASH FLOW (c)	(496)	1,206	362	341	321
NET CASH FLOW (a+b+c)	108	117	1,779	356	342
EO Items, Others	12	13	14	15	16
Closing Cash & Equivalents	202	319	2,098	2,454	2,796

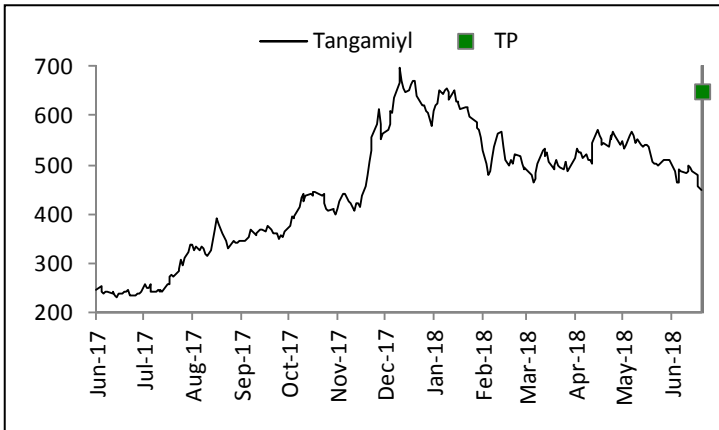
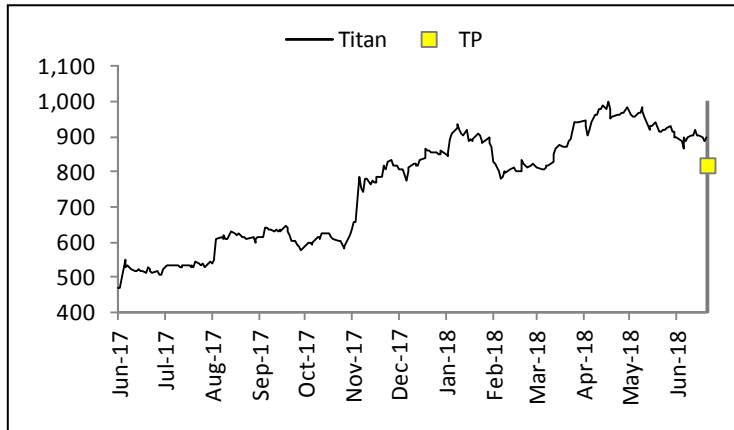
Source: Company, HDFC sec Inst Research

Key Ratios

	FY17	FY18	FY19E	FY20E	FY21E
PROFITABILITY (%)					
GPM	8.0	8.9	9.1	9.2	9.4
EBITDA Margin	3.7	4.3	4.6	4.8	5.0
EBIT Margin	3.0	3.7	4.0	4.3	4.5
APAT Margin	1.1	1.7	1.7	2.1	2.2
RoE	9.7	14.4	16.0	19.5	20.9
RoIC (or Core RoCE)	7.9	7.9	9.4	11.9	12.4
RoCE	7.8	7.6	8.2	9.1	9.5
EFFICIENCY					
Tax Rate (%)	27.6	32.6	33.0	33.0	33.0
Fixed Asset Turnover (x)	11.3	11.1	12.5	13.7	14.8
Inventory (days)	83	104	107	110	113
Debtors (days)	0	0	0	0	0
Other Current Assets (days)	4	4	4	3	3
Payables (days)	5	7	7	7	7
Other Current Liab & Provns (days)	6	10	27	27	27
Cash Conversion Cycle (days)	77	92	77	80	82
Net Debt/Equity (x)	1.5	2.1	1.3	1.3	1.2
Interest Coverage (x)	1.9	2.7	2.2	2.4	2.6
PER SHARE DATA (Rs)					
EPS	10.2	16.7	21.0	29.6	37.1
CEPS	17.1	22.6	27.8	36.8	44.9
Dividend	2.0	3.5	4.8	6.8	9.3
Book Value	108.9	123.0	139.8	163.6	192.5
VALUATION					
P/E (x)	44.6	27.3	21.6	15.3	12.2
P/BV (x)	4.2	3.7	3.3	2.8	2.4
EV/EBITDA (x)	17.4	16.4	11.3	9.7	8.5
EV/Revenues (x)	0.6	0.7	0.5	0.5	0.4
OCF/EV (%)	7.6	(11.0)	16.7	(0.1)	0.0
FCF/EV (%)	7.2	(12.0)	15.7	(1.1)	(1.1)
FCFE/Mkt Cap (%)	4.6	0.9	28.5	5.2	5.2
Dividend Yield (%)	0.4	0.8	1.1	1.5	2.0

Source: Company, HDFC sec Inst Research

RECOMMENDATION HISTORY



Date	CMP	Reco	Target
21-Jun-18	896	NEU	820

Date	CMP	Reco	Target
21-Jun-18	449	BUY	650

Rating Definitions

- BUY : Where the stock is expected to deliver more than 10% returns over the next 12 month period
- NEUTRAL : Where the stock is expected to deliver (-)10% to 10% returns over the next 12 month period
- SELL : Where the stock is expected to deliver less than (-)10% returns over the next 12 month period

INSTITUTIONAL RESEARCH
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