Rating Rationale for Thangamayil Jewellery Ltd.'s IPO Grading

Thangamayil Jewellery Ltd	IPO Grading: BWR IPO Grade 3 (Average Fundamentals)

Brickwork Ratings has assigned BWR IPO Grade 3 for the proposed IPO of Thangamayil Jewellery Limited (TJL). Brickwork Ratings' BWR IPO Grade 3 indicates average fundamentals for the issue in relation to its peers. BWR assigns IPO grading on a scale of IPO Grade 5 to IPO Grade 1, with Grade 5 signifying strong fundamentals and Grade 1 signifies poor fundamentals of the issue in relation to its peers.

The grading factors TJL's position in Tamil Nadu gems and jewellery market, aggressive expansion plans in tier 2 cities of Tamil Nadu, management's experience and understanding of jewellery market, large customer base in Madurai. However, the grading is constrained by TJL's lack of presence in other parts of the country, competitive industry, volatility in the gold prices and past record of negative cash flows from operations. The project is not appraised by term lending institution and is fully funded by IPO proceeds and internal accruals.

Company Profile

TJL is one of the leading retailers in Gold Jewellery, Diamond and Platinum Jewels based in Madurai. Incorporated as a Private Limited Company in the year 2000, the business was carried on by the promoters of the company in the name of Balu Jewellary since 1984. TJL retails made to order jewellery. It is also engaged in jewellery trading. The company presently has jewellery showrooms in Rajapalayam, Karaikudi and Ramanathapuram.

During the year FY07 and FY08, TJL has acquired two associate companies namely Thangamayil Gold and Diamond Private Limited and Balusamy Silvears Private Limited respectively in order to optimize the synergies in the conduct of business. Both the acquired companies had weak financials.

Management

TJL is promoted by three entrepreneur brothers - Mr. Balarama Govinda Das (aged 52 yrs), Mr. Ba. Ramesh (aged 46 yrs) and Mr. N.B. Kumar (aged 42 yrs). TJL's management is headed by Mr. Balarama Govinda Das (Managing Director) who has B.Com degree while Mr. Ba. Ramesh and Mr. N.B. Kumar are the Joint Managing Directors.

Mr. Balarama Govinda Das is in the business gold and diamond jewellery for more than 30 years. He is credited to have brought changes in the trends and designs prevalent in jewellery industry in and around Madurai.

Mr. Ba. Ramesh joined the family business of trading in gems and jewellery at the age of 18 years. He introduced 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). He has extensively travelled to various countries and has been responsible for modernizing the outlook of the company.

Mr. N.B. Kumar entered the family business in 1982. He manages the day-to-day affairs of the company and is in charge of the entire human resources in the company. He is credited to have streamlined the company's operations and the cost structure.

Mr S. Rethinavelu is an Independent Director on the Board. He holds B.Com, B.L degrees and is an advocate by profession. Mr S. Rethinavelu is the President of Tamil Nadu Chamber of Commerce and Industry, Madurai. He is an industrialist and manages a polytex unit in Madurai.

Mr. Lalji Vora, B.Com an Independent Director on the Board, is a businessman in Madurai dealing in textile and related activities for over 30 years. Mr. Vora is a partner in Milan, Milt Mart, Milan Mart, textile shops at Madurai and is also on the board of Milan textile Enterprise Pvt. Ltd., Madurai.

Mr. V.R. Muthu, B.Com (Hons), an Independent Director on the Board, is a businessman. He has experience in oil industry and is a partner in "Idhayam Till Oil" Manufacturing Company and has experience in the oil industry. He has been teaching young entrepreneurs through various forums organized by the Rotary Club and Chamber of Commerce.

Corporate Governance

In order to comply with provisions given in Clause 49 of the Listing Agreement, TJL has re-constituted its Board of Directors and has formed various committees namely Audit Committee, Share Transfer Committee, Investor Grievance Committee and Remuneration Committee. The company has adopted Corporate Governance practices to enable the Board to function independently while ensuring transparency. Presently, the company has Six Directors on the Board that includes the promoters while three members are Independent Directors. The Board members have expertise in different sectors which fit the company's needs.

Objectives of the issue

TJL is raising equity funds to expand existing business by establishing retail outlets at Tuticorin, Dindigul, Theni, Nagercoil, Tirunelveli, Kovilpatti and Sivakasi and to renovate the existing outlet at Madurai and to meet the working capital requirements. Part of the issue proceeds will be used to meet the issue expenses and for listing the company's share on stock exchanges. Table 1 gives summary of the project cost.

Table 1: Cost of the Project

Particulars	Total Cost (in Rs. Crores)
A. Setting up of retail outlets	
Land	5.05
Building	2.85
Interiors	9.42
Other Assets	4.12
Sub Total	**21.43**

Contingencies @ 5% of cost of Land, Building, Interiors and other assets	1.07
Total- A	**22.51**
B. Working Capital	22.78
C. Public Issue Expenses	2.55
Total (A+B+C)	**47.84**

The project is in very preliminary stage and the company has spent Rs 25 lacs as lease deposit towards the showroom proposed at Dindigul. TJL is yet to shortlist the sites for its showrooms at some of the locations mentioned above. The company has not entered into contracts with the contractors for construction of the showrooms. Any delays in the implementation of the projects can lead to cost and time overruns and can adversely affect the company's operations.

Project Funding

To meet the funding requirements, TJL plans to issue [#] * Equity Shares of Rs. 10/- each at a premium to be decided later and internal accrual. The promoters are not participating in the public issue. The funding requirements for the project is neither appraised nor funded by any term lending / financial institution. In absence of participation by term lending / financial institution the utilization of issue proceeds will be by the company.

The average cost of subscription to equity shares by promoters Mr. Balarama Govinda Das, Mr. Ba. Ramesh, and MR. N.B. Kumar are Rs. 11.85/-, Rs. 12.01/- and Rs. 11.85/- per equity share respectively. Table 2 gives present shareholding pattern of the company.

Table 2: Shareholding Pattern

	Pre-Issue (%)	Post-Issue (%)
Mr. Ba. Ramesh	29.34	*
Mr. N.B. Kumar	29.08	*
Mr. Balarama Govinda Das	29.07	*
M/s Thangamayil Gold & Diamond (P) Ltd.	6.84	*
M/s Balusamy Silvears Jewellery Pvt. Ltd	2.87	*
Mr. S Saravanan	0.44	*
Mrs. K. Tamarai Selvi	0.25	*
Mr. N.B Arun	0.25	*
Mrs. Ba. R. Darmini	0.25	*
Ms. P Sudha	0.26	*
Others	1.39	*
GRAND TOTAL	**100**	**100**

Industry Risks

Indian gems and jewellery industry is one of the fastest growing segments with annual growth rate of approximately 15 percent. India accounts for almost one-fifth of world consumption of

*To be disclosed by the company

gold. The domestic market is estimated at USD 16 billion or Rs 74,400 crores (INR/1 USD: 46.5 as on 16 November 2009) and is expected to grow to USD 25 billion or Rs 116,250 crores (INR/1 USD: 46.5 as on 16 November 2009) in the next three years. Gold jewellery accounts for about 80 percent of Indian jewellery market while fabricated/studded jewellery which includes diamond and gemstones studded accounts for the remaining portion of the market.

The Indian gold processing industry is highly competitive with about 80 percent market constituted by small, unorganized players. The branded jewellery market is becoming popular and the market for branded jewellery is expected to be worth USD 2.2 billion or Rs 10,230 crores (INR/1 USD: 46.5 as on 16 November 2009) by 2010. The domestic demand for jewellery products is highly discretionary and seasonal in nature with significant demand registered during festivals. The festival sales account for almost 70 percent of the annual jewellery sales and are expected to grow by 20 percent over FY08. Raw material cost accounts for over 90 percent of total expenses and about 94 percent of total sales. Due to increase in world gold prices, the raw material expenses have grown sharply which has affected the profit margin of the industry. Overall outlook for the industry is positive and growth is expected in all segments with the economy recovering from downturn.

Business Risks

TJL is engaged in the business of manufacturing and trading of jewellery for over 25 years and has four retail outlets in and around Madurai. The company enjoys a market share of over 15% in the sale of gold and diamond jewellery in the city of Madurai. The company has installed sophisticated machinery for measuring the quality and carat value of the gold. TJL ensures quality standards by hallmarking their products. The business is conducted under the brand name “Thangamayil Jewellery” which is strengthened by initiatives like quality and price assurances, advertising and enhancing customer experience. The branding initiatives have helped the company to increase the customer base to over 1 lakh.

The company has a manufacturing unit near Madurai which services the specific requirements of the customers. The company has also established network with dealers/suppliers based in other states from which it can source readymade products in order to meet the demand.

TJL faces risks in the jewellery retailing business which is highly competitive industry and is dominated by number of small, unorganized players. The entry of bigger players with more financial strength in terms of spending, advertising, maintaining higher levels of inventory etc may affect the TJL’s profitability.

Volatility of gold prices renders TJL’s sales susceptible to fall in demand. While the company has opened outlets at three locations and is planning to set up showrooms across the state, however, its geographical presence is not well diversified. Additionally, the company has to maintain a higher inventory level which increases the threat of commodity risk.

Financial Performance

During FY07-FY09, TJL has opened three new branches and has also acquired two companies namely Thangamayil Gold & Diamond Pvt. Ltd. and Balusamy Silvears Jewellery Pvt. Ltd. As a result, the operating income increased from Rs 224.5 crores in FY08 to Rs 246.83 crores in FY09. However, the net profit after tax (PAT) has increased marginally from Rs 5.61 crores in FY08 to Rs 7.5 crores in FY09, mainly due to increase in prices of raw materials and other expenses. The cash flows from operating activities of TJL have been negative for last three years due to higher current assets especially inventories that are required to be maintained at the new showrooms in order to meet the demand. The cash flows from investing activities have also been negative for last three years due to purchase of fixed assets on account of setting up of new showrooms. Table 3 gives snapshot of the Profit and Loss statement of TJL.

Table 3: Abridged Profit and Loss statement

	2009	2008	2007
I. INCOME			
Sales & Operating Income	246.8	224.5	127.2
TOTAL INCOME	**246.9**	**224.6**	**127.2**
II. EXPENDITURE	**230.2**	**213.8**	**120.8**
III. NPBIDT	**16.7**	**10.8**	**6.5**
Less: Interest & Finance charges	4.6	2.0	1.5
Less: Depreciation	0.6	0.3	0.2
V. NET PROFIT BEFORE TAXATION	**11.5**	**8.5**	**4.7**
Less: Taxes	4.0	2.9	1.6
VI. NET PROFIT AFTER TAXATION	**7.5**	**5.6**	**3.1**

The operating profit margin and net profit margin stood at 7.61% and 3.60% respectively during FY09, comparable to the industry figures. The Return on Capital Employed was high at 31% for FY09 but had declined from 35% during FY08.

The total debt to equity ratio has increased from 0.88 times in FY08 to 1.61 times during FY09. The total debt as on 31st March, 2009 stood at Rs 43.4 crores of which Rs 41.8 crores was short term debt in form of working capital loans. Contingent liabilities as of March 31, 2009 were Rs. 0.22 crores. Summary of key financial performance parameters is shown in Table 4.

Table 4: Key performance indicators

Particulars	2009	2008	2007
Operating profit margin [EBITDA/Operating Income]	7.61%	5.66%	6.16%
Net profit margin [PAT/Operating Income]	3.60%	3.06%	3.17%
Return on Capital Employed (%)	31%	35%	36%
Debt - Equity Ratio (times)	1.61	0.88	1.85
Interest Coverage Ratio (times)	4.08	6.44	5.29
Total Debt (Rs crores)	43.40	20.21	16.28
Net worth (Rs crores)	27.04	22.91	8.82

Table 5 gives the comparison of key financial ratios of TJL with its peers. It may be noted that TJL has significantly higher inventory level compared to that of peer's average during FY09.

Table 5: Key financial ratios (FY09)

Particulars	TJL	Peer's Average
Operating profit margin [PBITDA/Operating Income] (%)	7.61%	8.27%
Net profit margin [PAT/Operating Income] (%)	3.60%	4.78%
Return on Capital Employed (%)	31%	14.27%
Net worth (Rs crores)	27.04	292.3
Current Ratio (times)	8.97	3.43
Debt - Equity Ratio (times)	1.61	1.04
Interest Coverage Ratio (times)	4.08	3.0
Inventory/Assets (%)	79.67%	28.50%

Other factors –Compliance and Litigation

There are two cases of civil nature against the company involving an advertising agency and a customer for an aggregate amount of Rs. 0.57 crores. Except for the cases stated, there are no outstanding litigations, suits, criminal or civil prosecutions, proceedings or tax liabilities against the company, its promoters and there are no defaults, non-payment of dues to banks/financial institutions.

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