PC Jeweller Ltd

One-time assessment

CRISIL IPO Grade 3/5 (Average)

November 6, 2012

Grading summary

CRISIL has assigned a CRISIL IPO grade of '3/5' (pronounced "three on five") to the proposed IPO of PC Jeweller Ltd (PCJ). This grade indicates that the fundamentals of the IPO are average relative to the other listed equity securities in India. However, this grade is not an opinion on whether the issue price is appropriate in relation to the issue fundamentals. The grade is not a recommendation to buy, sell or hold the graded instrument, its future market price or suitability for a particular investor.

PCJ is an established jewellery retailer in North India. The assigned grade reflects its seven-year-old presence and the ensuing strong reputation in an industry quintessentially benefited by the country's obsession for gold. Strong brand recall, successful branch expansion (from one to 30 showrooms in the past seven years) and stellar increase in gold prices have added shine to PCJ's top line, which has grown at a three-year CAGR of 69%. The grade factors in the resilience of demand for gold jewellery in India despite high gold prices; we expect demand to revive in the long term as gold prices stabilise. Compared with other gold jewellery players, PCJ's revenue mix leans towards higher-margin diamond jewellery, which is rewarding in the wake of increasing acceptance of diamond jewellery in India. The grade has also taken into account the expected increase in organised retail penetration in jewellery vis-à-vis the single-store format, which will benefit established players such as PCJ.

However, competition in the jewellery retailing market - likely to intensify following planned expansions by regional/traditional players - poses a significant risk. Further, PCJ's stores are concentrated in North India (four showrooms in New Delhi accounted for 44% of FY12 revenue from operations). PCJ's plans to add 20 showrooms by FY14 across India should mitigate the risk of regional concentration but the opening of new showrooms in a competitive market is likely to put pressure on profitability due to higher marketing expenses and working capital requirement. Also the compensation structure for key management personnel appears low which can result in attrition.

PCJ's revenue from operation increased at a three-year CAGR of 69% between FY09 and FY12 to Rs 30.4 bn, largely driven by branch additions and steady increase in gold prices. EBITDA margin remained steady at 9-10% over FY09-FY12 due to hedging of gold and stable overhead costs. PAT increased sevenfold over the past three years to Rs 2,313 mn in FY12. The company registered robust RoE of 55% over FY09-FY12.

About the company

The company was established in 2005 after a split between the two partners. PCJ (Delhi-based) is promoted by brothers Mr Padam Chand Gupta and Mr Balram Garg. The company retails gold jewellery (66% of FY12 revenue from operations) and diamond-studded jewellery (32%) under the "*PC Jeweller*" brand. It has 30 showrooms across 23 cities in North and Central India totaling ~164,572 sq ft as on September 30, 2012. The domestic market accounted for 67% of FY12 revenue from operations and exports the rest.

The company's manufacturing units for gold and diamond-studded jewellery are located in North India. It intends to add 20 new showrooms by FY14 using the proceeds from the planned IPO.

History and key milestones

Year	Key milestones
2005	Incorporation Opened showroom in Karol Bagh, Delhi
2007	Opened two showrooms in Noida and Panchkula Commenced exports from manufacturing unit at the Noida SEZ
2008	Opened two showrooms in Faridabad and Dehradun
2009	Commencement of operations at the manufacturing unit in Selaqui, Dehradun Opened two showrooms in Pitampura and Chandigarh
2010	Commencement of operations at the second manufacturing unit in Selaqui, Dehradun Opened nine showrooms in Preet Vihar (Delhi), Ghaziabad, Gurgaon, Lucknow, Indore, Bhopal, Raipur, Jodhpur and Bhilwara
2011	Conversion from a private limited company to a public limited company Commencement of operations from the second export unit in the Noida SEZ Opened eight showrooms in Ludhiana, Haridwar, Bilaspur, Pali, South Extension, Beawar, Ajmer and Amritsar
2012	Opened six showrooms in the first nine months of 2012

Source: DRHP, Company

Issue details

Shares offered to public	45,133,500
As per cent of post issue equity	25.2%
Object of the issue	• Finance the establishment of new showrooms • General corporate purposes
Amount proposed to be raised	Not available at the time of grading
Price band	Not available at the time of grading
Lead managers	SBI Capital Markets Ltd, Kotak Mahindra Capital Company Ltd, IDBI Capital Market Services Ltd

Source: DRHP

Use of IPO proceeds

Sr .No	Expenditure item	Estimated cost (Rs mn)
1a.	Capex for the establishment of new showrooms	599
1b.	Estimated cost of finished products	5,100
1c.	General corporate purposes and issue expenses	N.A
	Total	5,699

Note: Rs 599 mn towards capital expenditure of 20 showrooms with total area of 133,000 sq ft translating into capex of Rs 4,500 per sq ft

Source: DRHP

Shareholding pre- and post-issue

Category of equity shareholders	Pre-issue		Post-issue	
	No. of equity shares	%	No. of equity shares	%
Promoter & promoter group	**125,404,500**	**93.6**	**125,404,500**	**70.0**
Padam Chand Gupta	50,371,800	37.6	50,371,800	28.1
Balram Garg	66,002,700	49.3	66,002,700	36.9
Promoter group	9,030,000	6.7	9,030,000	5.0
Others	8,562,000	6.4	8,562,000	4.8
Public			**45,133,500**	**25.2**
Total	**133,966,500**	**100**	**179,100,000**	**100**

Source: DRHP

Detailed Grading Rationale

A. Business Prospects

Gold demand weakens in H12012 but long-term story intact

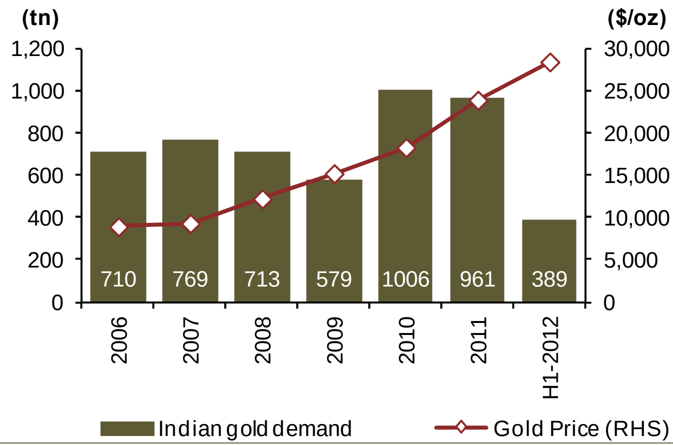
Demand for gold jewellery (65% of India's overall gold demand) has historically been resilient despite a significant increase in gold prices. In 2010 and 2011, when gold prices consistently scaled new heights, demand for gold (jewellery+ investment) in India continued to be high at 1,006 tonnes and 961 tonnes, respectively. India's demand for gold touched an all-time high in 2010 but declined by just 4% in 2011 due to a 31% rise in the rupee price of gold. In H12012, local demand for gold has weakened with a 20% rise in prices. Further, higher gold imports prompted the government to hike the import duty on gold to 4% of the value in March 2012 to cap the widening current account deficit. Hike in import duty, rise in international gold prices and a weak rupee resulted in 33% y-o-y decline in gold imports to 389 tonnes during H12012, according to the World Gold Council (WGC) report; however, in value term, it declined by only 10%. Although short-term demand is expected to be subdued on account of a sharp rise in gold prices, demand should revive in the medium to long term as gold prices stabilise.

Jewellery dominates gold demand

Gold demand in India (Tonnes)	2009	2010	2011	H1-2012
Jewellery	442	657	595	277
Retail investment	136	349	366	112
Total	579	1006	961	389

Source: WGC

Demand for gold weakened in H12012



Source: WGC, CRISIL Research

Gold is still considered a good investment

In India, gold is perceived as:

- An easily encashable asset or investment
- A financial security and an indicator of social status
- An asset passed on from one generation to another

These fundamental factors have kept Indians' demand for gold relatively resilient over the past few years despite a steady rise in prices.

Branded jewellery – greater acceptance…

Jewellery sales remain the stronghold of traditional jewellers and local outlets. However, the share of organised players (defined as retailers with more than one store in similar formats) is expected to increase from the current 8-10%. Multi-store players including regional/traditional players such as PCJ, Thangamayil Jewellery, Tribhovandas Bhimji Zaveri, Joyalukkas, GRT Jewellers, Swarovski, etc. as well as pan India jewellery players such as Tanishq and the diamond-focused Gitanjali, who sell jewellery under various brand names, are set to gain. Extensive marketing promotion by major players, rising awareness about hallmarked jewellery, contemporary designs and aspirational value of brands are collectively prompting a preference for organised jewellers from traditional family jewellers.

… to benefit established players with rising organised retail penetration

Traditionally, the jewellery retailing space in India has been dominated by the family jeweller largely due to factors such as considering certain jewellers as trustworthy and auspicious. As a result, organised retail penetration (ORP) in domestic jewellery retailing is estimated to be a mere 8-10%. However, this is expected to increase on the back of:

- Higher disposable income
- Increasing customer awareness about hallmarking (quality assurance). The recent approval on mandatory hallmarking will also accelerate the pace
- Assured buy-back scheme by organised players (since jewellery is seen as an investment)
- Aggressive branding by organised players
- Retail distribution allowing customers across locations to enjoy similar experiences leading to greater convenience

Established players such as PCJ are well placed to benefit from this shift in consumer preference.

Players' profile	Unit	PCJ	TBZ	Thangamayil	Gitanjali	Titan (Tanishq)
Sales (FY12)	Rs mn	30,419	13,854	11,136	77,554	70,450
Sales 3-yr CAGR	%	69%	27%	66%	42%	32%
No. of stores (POS) in FY12	no	24	15	15	4,000 #	163
Current sq ft (FY12)	sq ft	137,937	52,000	34,000	1,700,000	461,000
Average store size (FY12)	sq ft	5,747	3,467	2,267		
Diamond-studded jewellery sales (FY12)	%	~32	~25	~5	~55	>75
Retail model		Own stores	Own stores	Own stores	Franchisees, SIS, own stores and distributors	Franchisees

#Largely through distributors

Source: CRISIL Research

Globally, preference for branded jewellery is evident

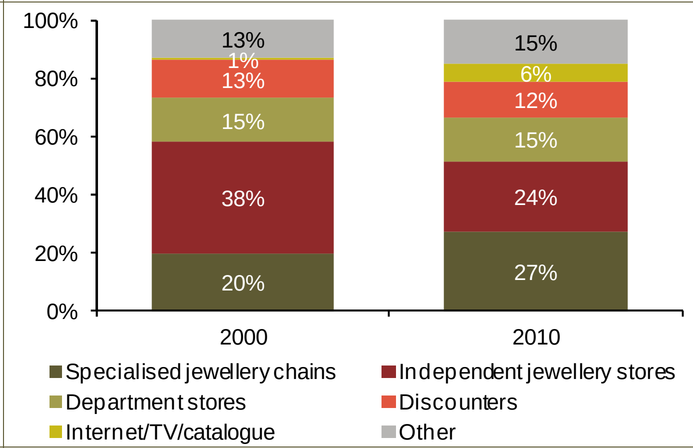
Reputed branded players stand to gain from the growing preference for branded jewellery. Jewellery retailing has typically been a fragmented business, characterised by a large number of small retailers across major markets in the world. Global retail chains have been expanding their footprint over the past decade and the share of independent retailers has declined at an average rate of 1.6% each year between 2000 and 2010. This trend is likely to continue, creating vast opportunities for the growth of branded jewellery across geographies especially with India and China emerging as key jewellery markets.

Between 2000 and 2007, jewellery demand in India and China has grown the fastest. The share of these two countries in global jewellery demand increased from 28% to 35% in this period. With wealth increasingly flowing into these two countries, jewellery demand in these geographies is expected to grow at a CAGR of 6% from 2011 to 2014.

Demand for jewellery growing in China and India

Source: CRISIL Research

Rise in share of branded players across markets



Source: CRISIL Research

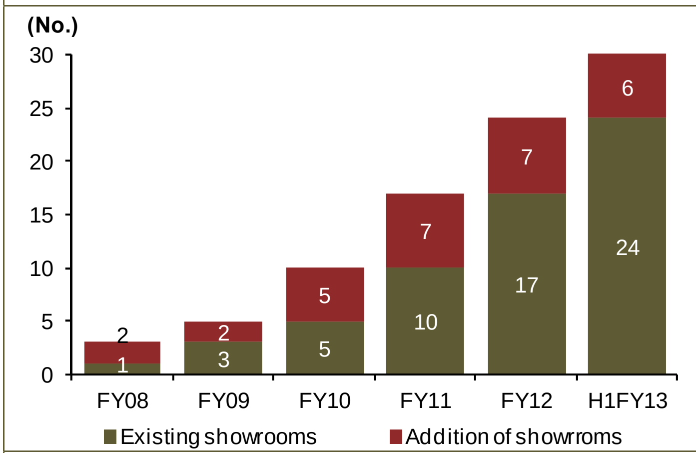
Vast experience and strong execution = faster growth for PCJ than peers

With more than two decades of experience of its promoters in the manufacture and retail of hand-crafted gold jewellery, PCJ has been able to create a strong brand recall in the Delhi region. Over the past three years, the company has increased its retail presence in other parts of North and Central India. It has expanded at a faster pace compared to other organised players and has been able to turn stores profitable right from the first year of operations.

PCJ has been able to diversify its revenue through domestic and export markets. In the domestic market it has a presence in gold and diamond-studded jewellery, with wedding jewellery accounting for 80%. As the focus is more on higher value items (wedding jewellery purchases are planned purchases, unlike fashion jewellery sales which are largely impulsive) the average size of a showroom is more than 5,500 sq ft compared to 2,500-3,500 sq ft for other players. It currently operates 30 showrooms and plans to open 20 showrooms by FY14 across India; these showrooms with average size of 6,650 sq ft are also expected to come up on high streets and market places.

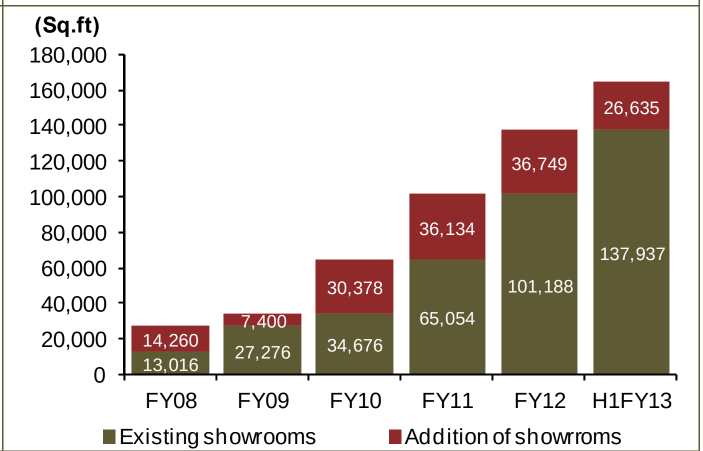
Over the years, PCJ has developed a strong in-house design team and five manufacturing facilities which cater to 70% of its demand. Apart from self-manufacturing, it also procures gold jewellery from more than 1,000 local suppliers in Kolkata, Rajkot, and other parts of the country, enabling it to offer regionally stylised design.

Stores – added six showrooms on an average

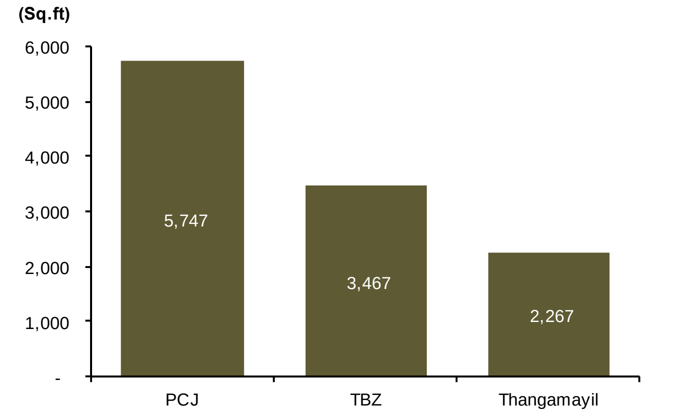
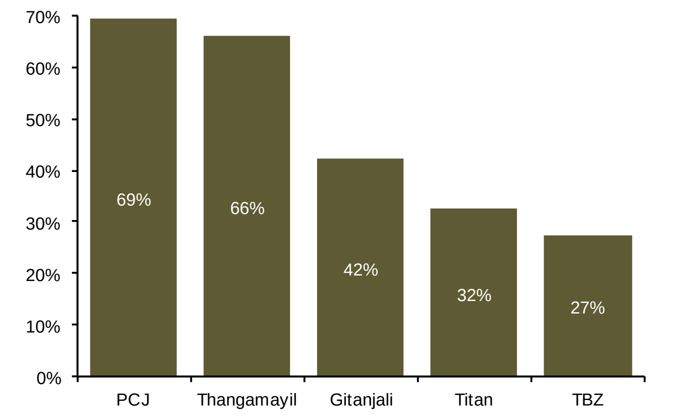


Source: Company, CRISIL Research

Space – added more than 30,000 sq ft each year



Source: Company, CRISIL Research

Large format stores favourable for wedding jewellery	Clocked faster growth vs peers (FY09-12 revenue CAGR)
	
Source: CRISIL Research	**Source: CRISIL Research**

Prudent hedging policy helps lower price risk

PCJ procures 100% of the gold required for its manufacturing operations under the gold loan schemes from canalising agencies and international bullion suppliers. Under such an arrangement, the price of gold purchased is not fixed on procurement but rather within the applicable credit period on the basis of prevailing gold rates on sale to customers, thereby providing a hedge from risks associated with gold price fluctuations between the time of procuring the raw material and selling the finished product to the customers. This protects the company from a sharp fall in gold prices and limits the upside in terms of inventory gain. Further, PCJ keeps a forex exposure hedge (for export revenue), avoiding adverse impact from forex fluctuation.

Focus will be on diamond jewellery in the domestic market…

Compared to other large traditional/regional players, PCJ has been increasing its focus on diamond-studded jewellery, which contributed 18-20% to overall sales over the past three years. The company's diamond business has been generating gross margins of 26-28% as compared to 9-10% in gold jewellery. Rising proportion of diamond jewellery and slower growth in export market have helped PCJ maintain its margins.

Profitability/Ratios (%)	PCJ	TBZ	Thangamayil	Gitanjali	Titan
EBIT margin (3-yr avg.)	10.1	6.7	8.6	9.0	8.7
PAT margin (3-yr avg.)	7.7	3.0	4.3	5.0	6.1
RoE (3-yr avg.)	54.4	38.1	42.5	35.0	39.0
RoCE (3-yr avg.)	43.1	25.5	32.6	32.0	57.0

Note: FY10-12

Source: CRISIL Research

… and not on exports due to rising competition

Domestic sales contribute about 67% to revenue from operations and exports make up the remainder; PCJ exports to Dubai, Singapore and Hong Kong. It exports to wholesalers with whom it enjoys a long-term relationship. These wholesalers, in turn, sell to other retailers as well as international buyers. The company's gold jewellery exports are not backed by any documentary credits, and, hence, the items can be exported only to trusted buyers. Going forward, the focus on exports will be lower due to rising competition from other countries. Therefore, export revenues will continue to contribute Rs 10 bn over the medium term resulting in a decline in exports. This move is likely to help the company to reduce its working capital cycle in the long term as inventory and debtor days are higher in the exports market compared to the domestic market.

Robust performance on home turf, stabilising in other parts

PCJ is a regional player with a presence primarily in North India. PCJ has gradually expanded from its flagship showroom in Karol Bagh, New Delhi to other parts of North and Central India. Although the company has a strong brand value in areas around Delhi, it is yet to establish a similar brand pull in other parts. Showrooms outside Delhi (20) have much lower average sales per sq ft than the four showrooms in New Delhi. In FY12, Delhi stores (24.4% of total area) accounted for 44% of revenue from operations; in H1FY13 their contribution reduced to 34% with stabilisation of stores in other cities.

	Area (sq ft)			Revenues (Rs mn)			Revenue per sq ft per month (Rs)		
	FY11	FY12	H1FY13	FY11	FY12	H1FY13	FY11	FY12	H1FY13
Stores in Delhi	24,436	32,436	32,436	4400	8932	4235	15,007	26,170	21,762
Stores outside Delhi	76,752	105.501	105.501	5701	11462	6442	8,394	10,530	10,658
Total	101,188	137,937	137,937	10102	20394	10677			
Proportion for stores in Delhi	24.1%	24.4%	24.4%	43.6%	43.8%	39.7%			

*Analysis done for 24 stores existing as of FY12 (details on six new stores not taken into consideration)

Source: Company, CRISIL Research

With rise in competition, ability to replicate success in West and South India is a monitorable

PCJ opened one showroom each in Kanpur, Indirapuram and Ghaziabad and three in New Delhi in H1FY13. It plans to add 20 more showrooms by FY14 across India - 12 in the South and West and the remaining in the North and East. In larger cities, especially in western and southern India, the jewellery retailing market is getting increasingly competitive, evidenced by slow growth and decline in the same store sales of existing organised players. With many regional and national jewellery retailers as well as jewellery manufacturers and exporters lining up aggressive expansion plans, competition is expected to intensify.

While this pans out, the shift from unbranded jewellery to branded jewellery should provide some room for the players to co-exist and compete on customer loyalty and variety, underlined by quality assurance. On the flip side, this will likely lead to higher spending on advertising, lower volumes and realisations and/or suppressed margins on gold jewellery. The company does not have any presence in the southern and western regions. Given, the lower pick-up in stores outside Delhi, PCJ's ability to successfully penetrate these regions and establish a brand is a key monitorable.

B. Financial Performance

PCJ's FY12 operating income was Rs 30.4 bn; it reported CAGR of 75% over FY08-12 driven by new showrooms additions and improvement in same store sales. EBITDA margin has been steady at 9-10% over the past four years as PCJ is completely hedged against gold price fluctuations and has stable overhead costs. Greater contribution from the high-margin diamond business has also supported EBITDA margin. Strong revenue growth along with stable EBITDA margin resulted in robust PAT growth of 106% CAGR to Rs 2,313 mn in FY12 from Rs 130 mn in FY08. The company has operated at a low effective tax rate of 12.7% due to zero tax on exports from its SEZ in Noida. PCJ has managed to maintain the gearing at 1.0x despite being in an expansion mode. Its net worth is Rs 5.6 bn.

Financial performance snapshot

Particulars	FY08	FY09	FY10	FY11	FY12	H1FY13
Total operating income (Rs mn)	3,214	6,241	9,859	19,772	30,419	18,557
EBITDA margin (%)	6.8	9.6	10.0	9.9	10.9	12.6
Adjusted net profit / (loss) (Rs mn)	130	310	665	1,453	2,313	1,413
Adjusted net margin (%)	4.0	5.0	6.7	7.4	7.6	7.6
RoCE (%)	26.2	30.9	35.3	53.3	40.7	NA
RoE (%)	40.1	55.1	53.1	57.8	52.5	NA
Adjusted EPS (Rs)	5.9	14.0	16.6	32.5	17.3	NA
No. of equity shares (mn)	22.2	22.2	40.2	44.7	134.0	NA
Net worth (Rs mn)	398	727	1,778	3,254	5,560	NA
Debt-equity ratio (x)	1.4	2.9	0.5	0.4	1.0	NA

Note: The financial numbers in this document has been re-classified as per CRISIL's standard and, hence, may not match with DRHP numbers.

Source: DRHP, CRISIL Research

C. Management Capabilities and Corporate Governance

Management has vast experience in the jewellery retail business

PCJ's top management is led by Mr Padam Chand Gupta (chairman) and Mr Balram Garg (managing director) supported by Mr Gupta's sons. The top management has vast experience in the manufacturing and retailing of gold and diamond-studded jewellery.

Aggressively expanded post-split; has been able to turn stores profitable from first year of operations

After a split in the family business in 2005, PCJ has opened 29 new showrooms (between 2007 and H1FY13) in different states across India; the total number of showrooms, as on September 30, 2012, is 30. The pace of expansion has been faster compared to other players in the industry with addition of ~25,000 sq ft retail space every year. The stores have been profitable right from the first year of operations. PCJ plans to add 20 new showrooms in FY14 using the IPO proceeds. Though the pace of expansion is fast, we believe that the company will be able to achieve its target given the track record.

Board composition and independent directors

The board comprises four directors, of whom two are independent directors. The independent directors have been on the board since September 2011. Mr Manohar Lal Singla has over 25 years of experience in the field of education and is currently a professor in Faculty of Management Studies, Delhi. Mr Krishnan Kumar Khurana is a practicing advocate of the Supreme Court of India and the High Court of New Delhi.

Compensation level of key management personnel is low

The compensation structure for key management personnel appears low which can result in attrition. However, most of the senior people in the management have been associated with the company for a long time which minimises this risk.

Name and Designation	Salary – FY11 (Rs lakh)
Mr R K Sharma (55) - COO	6.5
Mr Sanjeev Bhatia (50) – President Finance	7.6
Mr R Sugla (37) – Senior VP Accounts and Taxation	7.0
Mr K Singh (34) – Senior VP Projects and Audit	6.4
Mr N Gupta (33) – President – Diamond Manufacturing	3.0
Mr S Gupta (36) – President – Gold Manufacturing	NA
Mr Vijay Pawar (37) – Company Secretary	4.0

Source: DRHP, Company

Annexure I

Business Profile

Retailing of gold and diamond-studded jewellery (67% of FY12 revenue from operations): PCJ sells jewellery made of gold, diamond and other precious stones, platinum and silver. As on September 30, 2012 it has 30 showrooms in 23 cities in North and Central India. PCJ sells its jewellery under the brand "PC Jeweller".

In FY11, gold jewellery contributed 66% to revenue from operations followed by diamond jewellery (32%) and other types of jewellery (2%). Diamond jewellery's contribution to revenue from operations has risen significantly from 6% in FY09 to 18% in FY11.

Jewellery exports (33% of FY12 revenue from operations): PCJ exports gold and diamond jewellery to international distributors in Dubai, Singapore and Hong Kong. In FY11 and FY10, exports contributed 34% to total sales.

Manufacturing facilities

Location	Commissioning date	Purpose	Area in sq ft
Noida SEZ, Uttar Pradesh	20-Nov-07	Jewellery for exports	36,570
Noida SEZ, Uttar Pradesh	3-Mar-11	Jewellery for exports	3,938
Selaqui, Dehradun, Uttarakhand	30-Mar-10	Jewellery for domestic market	8,611
Selaqui, Dehradun, Uttarakhand	20-Feb-09	Jewellery for domestic market	2,300
Noida, Uttar Pradesh	17-Nov-11	Jewellery for domestic	34,000

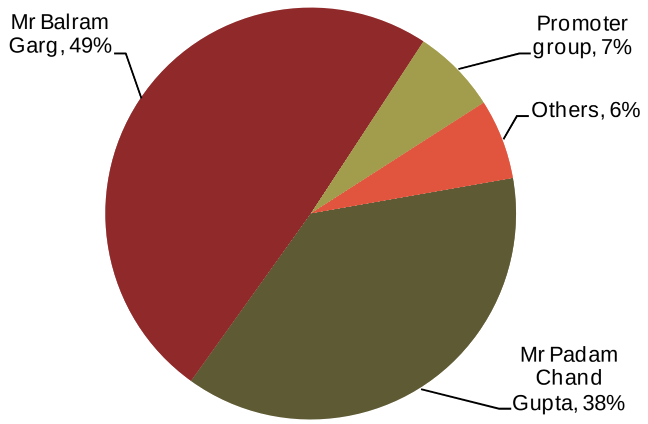
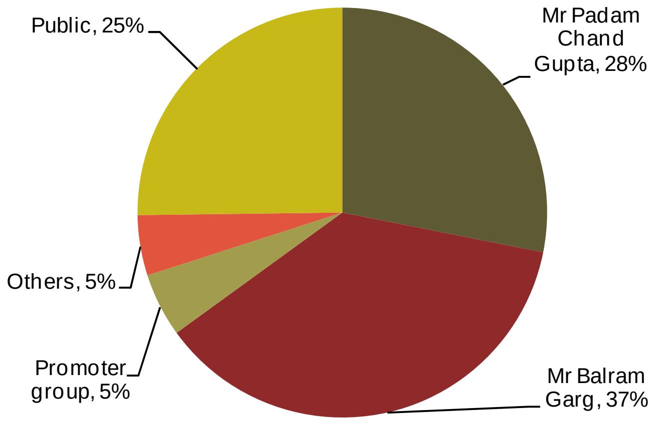
Source: DRHP, Company

Planned store details

Location	Size (sq ft)	Opening date
Ahmedabad, Gujarat	6,000	FY13
Bengaluru, Karnataka	10,000	FY13
Baroda, Gujarat	5,000	FY13
Bhubaneswar, Odisha	5,000	FY13
Coimbatore, Tamil Nadu	8,000	FY13
Jabalpur, Madhya Pradesh	4,500	FY13
Jalandhar, Punjab	10,000	FY13
Mumbai, Maharashtra	10,000	FY13
Nagpur, Maharashtra	5,500	FY13
Patna, Bihar	4,500	FY13
Ranchi, Jharkhand	4,500	FY13
Sriganganagar, Rajasthan	3,500	FY13
Surat, Gujarat	7,000	FY13
Chennai, Tamil Nadu	10,000	FY14
Guwahati, Assam	4,500	FY14
Hyderabad, Andhra Pradesh	8,000	FY14
Jaipur, Rajasthan	6,000	FY14
Jammu, Jammu & Kashmir	4,000	FY14
Kolkata, Paschim Banga	10,000	FY14
Mangalore, Karnataka	7,000	FY14
Total	**133,000**	

Source: DRHP, Company

Shareholding pattern

Pre-issue shareholding pattern	Post-issue shareholding pattern
	
Source: DRHP	**Source: DRHP**

Annexure II: Profile of the Directors

Name	Designation	Age	Qualification	Date of appointment	Experience	Directorships in other entities
Padam Chand Gupta	Chairman and Non-Executive Director	58	NA	Since inception	More than 20 years in the jewellery industry	1. Jagram Finvest Pvt. Ltd
Balram Garg	Managing Director	42	B.Com	Since inception	More than 20 years in the jewellery industry	1. Trigun Infrastructures Pvt. Ltd 2. Amar Garments Pvt. Ltd
Manohar Lal Singla	Independent Director	54	Master's degree in Business Administration and Doctor of Philosophy in Management from the University of Delhi	September 2011	Over 25 years in education	
Krishan Kumar Khurana	Independent Director	55	Master's degree in Arts from Kurukshetra University, Kurukshetra; Bachelor's degree in Law from the University of Delhi	September 2011	Over 25 years in legal services	

Source: Company