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Fundamental Report of TBZ

TBZ or Tribhovandas bhimji zhaveri ltd is a 150+ year old firm based out of Mumbai. The company went public during the 2011-12 gold boom when a lot of jewellery companies were listed at the peak of the gold cycle.

The stock price of the company promptly popped after listing as gold prices kept rising and so did the reported profits. The company used the IPO funds to expand operations and doubled its store count from 14 to 28 over a span of three years

The expansion did not work out as expected and the per store sales has dropped by around 40% from the peak. This has led to high working capital and poor asset turnover ratio. In addition, a drop in gold prices and demonetization has further impacted the operating margin which have dropped from a peak of 9% to around 4% now.

A combination of poor execution and weak cash flow has also led to higher debt to finance the working capital (inventory) of the company. The net result of all these factors is a drop in ROC from roughly 20% to around 7% now.

The management is aware of the situation and has been working on raising the asset turns and operating margins to improve the return on capital. It is also working on an asset light model to grow the business without adding additional capital.

This idea is a bet that the management will be successful in executing as per its plans.

Industry review

The gems and jewellery industry is a traditional industry which has been dominated by local and regional retailers in the past. In the last 15 years, large regional and national levels players have been growing rapidly and have taken market share away from the smaller retailers

The organized/ large retailers now account for around 30% of the industry and these companies continue to grow faster than the market due to the following factors

- Preference of customers, especially the younger segment towards branded jewellery with latest design
- Hallmarking of jewellery leading to reduced pricing differential with the un-organized sector. In addition, GST and more stringent KYC norms mean that the price differential enjoyed by the un-organized sector is reducing further. This is driving a shift in demand to the larger players
- Investment by the larger players in branding via advertising and new retail outlets

The above trend is likely to act as a tailwind for the larger players and play out over a decade.

The organized sector consists of listed national players like Titan, PC jewellers and TBZ and several other large listed and unlisted companies such as thangamayil, Joyallukas, Bhimas, Kalyan etc.

In terms of products, the major revenue comes from plain gold jewellery, followed by studded jewellery (diamond and other stones) and finally other metals such as platinum (recently) and silver. The margin enjoyed in gold jewellery is in the range of 8-12% whereas diamond jewellery has much higher margins in the region of 30%

Positives

The company has a 150 year old brand which is considered synonymous with gold jewellery and trust in its legacy markets of Gujarat and Maharashtra. The company has been known for its design, especially in the wedding jewellery space. As a result of its brand and legacy, the company is able to earn a slightly higher gross margin on its products compared to other retailers.

Poor overhead and weak operational management has however meant that this higher gross margin has not translated into an equivalent operating margin. Management seems to be aware of this fact and is working on improving its operating margins by controlling the overheads and employee costs.

The company has been hurt by high inventory levels in the past and is now focused on managing the inventory levels. The absolute inventory has been kept steady inspite of a growth in the number of stores. Inventory turns should improve once the top line and same store sales pickup.

In addition to the above controls at the balance sheet level, the company is moving to an asset light franchisee model. If the company is successful, it would be able to grow much more rapidly with lower amounts of capital and higher ROC. The company plans to increase the retail space from 1.14 lacs to 1.5 lac sq ft in the near term, mostly via this model.

Risks

The stock idea of course has a lot of risks associated with it. For starters, the government continues to have a strange approach to the gold sector with sudden policy shifts in response to macro issues. Any negative regulation can hurt the industry in the short to medium term. The sector is also exposed to gold price fluctuations which can impact demand for short periods of time, though in the long run it is impossible to displace the country's love of gold.

In addition, the management has shown poor execution in the past and even now the jury is out on how much they will succeed.

Valuation

The company is **not underpriced** based on current numbers. If we extrapolate the current performance, the company is fairly or even slightly overvalued. We are betting on the numbers improving over time

If we assume that the management can get the operating margins to around 7% and grow its top line at around 18%, then the company should earn around 100 Crs in 3 years. At a sector average PE of 20-25, the company should be worth 2.5-3X the current price.

Conclusion

We feel that head winds in the sector are reducing and the company could benefit from the tailwind of demand migration to the organized sector. In addition, the management is now focused on improving the margins and the per store productivity in terms of sales. All these factors put together mean that the company could see an improvement in profitability and growth in the coming years.