July 17, 2019

Alukkas Jewellery Thrissur: Rating reaffirmed

Summary of rating action

Instrument*	Previous Rated Amount (Rs. crore)	Current Rated Amount (Rs. crore)	Rating Action
LT Fund based facilities	84.50	84.50	[ICRA]A- (Stable); reaffirmed
Total	**84.50**	**84.50**	

*Instrument details are provided in Annexure-1

Rationale

The rating reaffirmation considers Jos Alukkas Group's (the Group) established presence in South India and the extensive experience of its promoters in the gold jewellery retail industry. The ratings also factor in the stable revenue and earnings growth in FY2019e[1], comfortable gearing and debt coverage metrics of the Group. The sales growth has been aided by the increasing shift from unorganised to organised trade with formalisation of the sector although the overall demand sentiment was weak, and the group's continued efforts towards improving brand visibility.

The ratings, however, remain constrained by risks of geographic concentration with over half of its revenues derived from the Tamil Nadu market and low profitability margins due to the limited value addition done, a fragmented industry structure resulting in competitive pricing environment, a cautious lending environment and group's moderate liquidity profile. The ratings also factor in the high working capital intensity in the business due to high inventory holding requirements and the absence of formal hedging mechanisms, thereby exposing the margins to volatility in gold prices. The ratings also remain constrained by the accentuated regulatory risks which have affected both demand and supply in the past. The ratings also consider the risks inherent to partnership firm, in the form of limited disclosures, capital continuity/withdrawal risks.

Outlook: Stable

ICRA believes that Jos Alukkas Group's financial profile will be supported by steady demand, strong brand presence and extensive experience of the promoters. The outlook may be revised to Positive if substantial growth in gold sales volumes supports the revenues and margins and if better working capital management improves the overall financial profile. The outlook may be revised to Negative if lower-than-expected cash accruals or increased working capital intensity, or any major capex weakens the liquidity position.

Key rating drivers

Credit strengths

Extensive experience of the promoters and strong brand equity – The Jos Alukkas Group has been in the gold jewellery retailing business for over six decades, led by the promoter's strong experience and commitment in the business. With its long-standing presence, the Group has built a loyal customer base amidst competition from organised and unorganised players and has garnered a stable market share in the region it operates. The promoter's vast experience, coupled with focus on selling jewellery designs suiting the specific tastes and preferences of the customers enabled the

[1] e - estimated

Jos Alukkas Group to establish a strong brand equity in the southern Indian states, which has driven footfalls and volume growth over the years. Amidst heightened competition in the industry, the Group has sustained its market share led by its focused presence in Tier-2/3 markets, marketing initiatives and jewellery saving schemes targeting the middle-class customers.

Stable financial profile – Adjusted for the stock transfers done based on intra-group store re-organisation and accounting for vendor sales as sales (against job-work in the past), the revenues increased by ~8.8% in FY2019e. The adjusted volume and value growth for FY2019e was ~6% and ~3% for gold, which represents over 94% of total sales. The adjusted operating and net margins in FY2019e stood at 5.6% (down 30 bps) and 2.7% (down ~5 bps) respectively. The contraction in operating margins is primarily due to the pricing pressure from competition amidst rising gold prices and subdued demand. The Group's coverage indicators have remained moderate with interest coverage ratio of 3.8 times in FY2019e, while the net gearing and net TD/OPBITDA is estimated at 0.5 times and 1.7 times as of March 2019 respectively. Going forward, the revenue growth is expected to be augmented by planned store additions in the medium term while margins are expected to remain range-bound around the current levels due to competition. The group's capitalisation and coverage ratios are expected to be at current levels.

Favourable demand outlook for organised jewellery retailers over the medium term - Jewellery consumption in India has been traditionally driven by the strong cultural affinity for gold, with the metal being the preferred form of jewellery. Stable demand during wedding and festive seasons is likely to keep the sentiments strong. While the demand-supply metrics remain vulnerable to any policy initiatives of the Government, these regulations have resulted in faster formalisation of the sector, thus supporting organised retailers like Jos Alukkas.

Credit challenges

Geographical concentration risk and intense competition – The Jos Alukkas Group, being a South India based jewellery retailer derives over half of its revenues from Tamil Nadu with the balance revenues being distributed across Karnataka, Andhra Pradesh, Telangana and Kerala leading to geographical concentration risks. Nevertheless, the risk is mitigated by the Group's approach of targeting the Tier 2 / Tier 3 cities than metros, which have the advantage of lesser competitive intensity and lower operating costs than the latter. While the concentration risk is expected to remain high, its established brand presence and revenues from repeat customers acts as risk mitigants.

Gold jewellery retailing is competitive with large presence of large organised and unorganised players. This, coupled with the limited value addition, limits the pricing flexibility of the players resulting in thin operating margins. Further, as the retail business is working capital intensive in nature with adequate inventory required to be maintained across stores, earnings remain exposed to volatility in gold prices. The Group's net margin has remained thin over the years due to the Group's focus on the fast-moving low value-added gold jewellery and also on account of the increasing competition from established retailers in the Tier 2 / Tier 3 cities of southern India. However, the customer loyalty driven by strong brand equity has augmented the sales volumes over the years, thus resulting in stable profits in recent years.

High working capital intensity – Jewellery retailing is inherently working capital intensive on account of the optimal inventory required to be maintained across the stores. The Group's working capital intensity remains high, with adjusted inventory days of 131 days in FY2019e and the group is exposed to volatile gold prices in the absence of a formal hedging mechanism. The working capital intensity is likely to remain at elevated levels, given the store expansion plans of the Group, owing to the nature of the industry.

Accentuated regulatory risks and cautious lending environment – The jewellery retail industry has been witnessing increased regulatory intervention in recent years which consequently impacted the demand and supply scenario in the industry. Measures like 20/80 restriction on imports, limited access to gold metal loans, mandatory Permanent Account Number (PAN) disclosure requirement for purchases above Rs. 2 lakh, restrictions on jewellery saving schemes, imposition of excise duty, increase in import duty, demonetisation, GST etc, inclusion of jewellery sector under Prevention of Money Laundering Act (albeit for brief period) has had its effect on both demand and supply. Increasing supervision and cautious lending environment further restrict the fund flows to the sector, thus hampering the store expansion plans of retailers

Compliance risk inherent to partnership nature of business –One of the entities in the Jos Alukkas group, being a partnership firm is exposed to capital withdrawal risk, relatively lower compliance and disclosure standards. However, the other entities in the group are private limited companies, and this provides some comfort.

Liquidity Position:

The group's liquidity profile remains moderate driven by healthy accruals of ~Rs.100 crore per annum and absence of any major debt repayment obligations. The group also has modest capex plans of ~Rs.20 crore per annum over the medium term owing to store expansions using asset-light lease model. The group also had cash balance of Rs.67.6 crore as on December 31, 2018 (Provisional financials). Though the average working capital utilization for the twelve months ended May 2019 stood at ~90%, the group has got increase in sanction limit of Rs. 45.3 crore in April 2019 which shall improve the headroom against sanctioned lines.

Analytical approach:

Analytical Approach	**Comments**
Applicable Rating Methodologies	Corporate Credit Rating Methodology Rating methodology for Gold jewellery retail industry
Parent/Group Support	Not Applicable
Consolidation / Standalone	Consolidated

About the company:

The Jos Alukkas group of entities, with Mr. Jose Alukka as its Chairman, commenced jewellery retail operations in 2002 with a showroom in Thrissur, Kerala. The Group consisted of four entities, including AGRIPL, AEPL, AJT and Alukkas Jewellery Alappuzha (AJA) - of which the latter two being partnership firms. AJA was merged with AJT with effect from June 1, 2017 for better operating efficiency. The Group is currently managed by the promoter's three sons – Mr. Paul Alukka, Mr. Varghese Alukka and Mr. John Alukka. Currently, the Group has 41 stores across five states in South India.

Key financial indicators (Consolidated)

	FY2017	**FY2018**
Operating Income (Rs. crore)	2,366.3	4,448.2
Adjusted OI (Rs. Crore)	2,066.1	3,338.2
PAT (Rs. crore)	67.2	91.6
OPBDIT/OI (%)	5.4%	4.4%
Adjusted OPBDIT/OI (%)	6.2%	5.9%
RoCE (%)	16.1%	18.5%
Total Debt/TNW (times)	1.1	0.9
Total Debt/OPBDIT (times)	4.4	2.9
Interest coverage (times)	1.9	3.2

Source: Company

Status of non-cooperation with previous CRA: Not applicable

Any other information: None

Rating history for last three years:

		Current Rating (FY2020)				Chronology of Rating History for the past 3 years			
					Date &Rating	Date & Rating in FY2019	Date & Rating in FY2018	Date & Rating in FY2016	
	Instrument	Type	Amount Rated (Rs. crore)	Amount Outstanding (Rs Crore)	July 2019	April 2018	April 2017	Mar 2016	Jan 2016
1	Fund based facilities	Long Term	84.50	-	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)	[ICRA]A- (Stable)
2	Fund based sub-limits	Short Term	-	-	-	-[2]	[ICRA]A2+	[ICRA]A2+	-

Complexity level of the rated instrument:

ICRA has classified various instruments based on their complexity as "Simple", "Complex" and "Highly Complex". The classification of instruments according to their complexity levels is available on the website www.icra.in

[2] [ICRA]A2+ ; withdrawn

Annexure-1: Instrument Details

ISIN No	Instrument Name	Date of Issuance / Sanction	Coupon Rate	Maturity Date	Amount Rated (Rs. crore)	Current Rating and Outlook
NA	Cash credit	NA	NA	NA	84.50	[ICRA]A- (Stable)

Source: Alukkas Jewellery Thrissur

Annexure-2: List of entities considered for consolidated analysis

Company Name	Ownership	Consolidation Approach
Alukkas Enterprises Private Limited	NA	Full consolidation
Alukkas Gold Retail India Private Limited	NA	Full consolidation
Alukkas Jewellery Thrissur	NA	Full consolidation

ANALYST CONTACTS

Subrata Ray
+91 22 6114 3408
subrata@icraindia.com

K. Srikumar
+91 44 4596 4318
ksrikumar@icraindia.com

Ganapathy. R
+91 44 4297 4316
ganapathy.r@icraindia.com

RELATIONSHIP CONTACT

Jayanta Chatterjee
+91 80 4332 6401
jayantac@icraindia.com

MEDIA AND PUBLIC RELATIONS CONTACT

Ms. Naznin Prodhani
Tel: +91 124 4545 860
communications@icraindia.com

Helpline for business queries:

+91-9354738909 (open Monday to Friday, from 9:30 am to 6 pm)

info@icraindia.com

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ICRA Limited

Corporate Office
Building No. 8, 2nd Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002
Tel: +91 124 4545300
Email: info@icraindia.com
Website: www.icra.in

Registered Office
1105, Kailash Building, 11th Floor; 26 Kasturba Gandhi Marg; New Delhi 110001
Tel: +91 11 23357940-50

Branches

Mumbai	+ (91 22) 24331046/53/62/74/86/87
Chennai	+ (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294,
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