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"Gitanjali Gems Q1 FY12 Earnings Conference Call"

August 12, 2011

Moderator: Ladies and gentlemen, good day and welcome to the Gitanjali Gems Q1 FY 2012 results conference call. As a reminder for the duration of this conference all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. If you should need assistance during the conference please signal an operator by pressing * followed by 0 on your touchtone phone. Please note that this conference is being recorded. At this time I would like to hand the conference over to Mr. Sunil Varma, Group CFO, Gitanjali Gems. Thank you and over to you Sir.

Sunil Varma: Good evening ladies and gentlemen. Welcome to the first quarter results of financial year 2012 of Gitanjali Gems. We are pleased to announce yet another milestone of the results for the first quarter. We have achieved sales of Rs.2,595 Crores, a growth of 39% over the similar quarter last year. The Indian segment has been the primary driver with 64% growth this quarter. All our leading brands, Gili, Nakshatra, Asmi, D'Damas are transforming into retail stores. The total EBIT for the quarter has reached Rs. 198 Crores with a growth of nearly 45% over the last quarter. Profit after tax was Rs.124 Crores with a growth of nearly 55% over the comparable quarter. Economies of scale in our operations and expense control in certain categories have contributed to expansion in profits. Earnings per share for the quarter were nearly at 14.5 rupees, a growth of about 55% from the comparable quarter last year. With our continuous efforts to expand downstream jewellery retail has penetrated in the hinterlands of the country. We continue to focus on our retail expansion through franchising, modern retail and own stores. This year we have observed rapid growth in jewellery particularly in India and the Asian subcontinent. Worldwide this category has been doing well and has proven to be an investment asset class in times of uncertainty. Along with gold, diamonds have also grown as an asset class. We are pleased to be in this category with preferred asset class coupled with brand appeal during these uncertain times. The significant development in the quarter also includes expansion into gold jewellery. Our key brands have introduced gold jewellery collections and the sales are overwhelming. With the recent success in IIJS - the jewellery show, we are expecting all our brands to outperform the growth this year. We have better expectations from sales and even more from profitability with improved working capital cycle. Also to give you an update on the restructuring activity of the company we are working on with KPMG, the restructuring process is in the last phase of implementation and the new structure will be accomplished this quarter. Thank you very much.

Moderator: Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Ravichandran from Prodigy Investment Management. Please go ahead.

Ravichandran: I want you to throw some light on the change in your employee cost, which seems to have come down a bit as well as the depreciation and amortization number?

Sunil Varma: The reduction in employee cost is primarily, due to rationalization in America. The American business overall is now more profitable because we have rationalized cost there, also the depreciation has reduced because we had written off the goodwill last year in the American businesses, so this will not appear this year.

Ravichandran: Can you throw some light on the trend in employee cost going forward whether it is going to reduce further in the coming quarters or it will remain at these levels or grow from here?

Sunil Varma: Now it will remain at this level. This was only the reduction, which happened over the last year, so that is why the comparable numbers for this year are lower.

Ravichandran: Can you throw some light on the fact that gold prices have gone up a lot, diamond prices have gone up a lot, so the cost to the end consumer is obviously much more, is that going to impact demand in any way, are you seeing something like that?

Mehul Choksi: We have seen a continuous demand growth over last one year, of course the quantum growth has been more or less 15% only but value wise it has grown a lot, particularly in India, it has increased by nearly 60-65%. In this particular quarter and even in the previous quarter, we have seen that it has been in the asset class and basically I think people are going in for jewellery because of increased levels of confidence in jewellery as an investment since there are guidelines that gold will surge further. We have not seen any pause at all except on days of volatility , but other than that it is growing. Particularly, diamond jewellery, because of which more and more stores are keeping diamond jewellery and that is the reason they are experiencing growth.

Ravichandran: Would you say that some of these good numbers that you have shown is also because of inventory gains that have come through?

Mehul Choksi: We are completely branded and most of our products sell at the MRP level. If you see, our working capital cycle has improved significantly since the slowdown in 2008 and 2009 when we were experiencing elevated working capital levels., so there is a gain . Also, when price keeps on increasing there is a gain, and it shall continue to be so because the overall expansion in value is high compared to the expense which shall result in increase in profits

Ravichandran: Any view on diamond prices going forward, is this gain sustainable, what is the reason?

Mehul Choksi: For a while I personally feel that diamond prices will remain status quo. Demand is outstripping the supply, but in the last couple of months there have been lot of polished diamonds produced, so in my opinion it is a very comfortable situation for people like us who are probably not really looking at increase in the price of diamonds anymore from the supply side.

Ravichandran: What has helped you change your working capital cycle for the better?

Mehul Choksi: Basically we were a diamond jewellery manufacturer and supplier. Of course gold is a 30:70 portfolio but now in the last six months we have introduced gold aggressively because we saw the demand increasing in the country and particularly towards more trustworthy names and that is why our gold jewellery sells -- and because of this, our overall cycle has improved a lot and the business has been buoyant. In the last six months there has been a continuous higher demand compared to the supply.

Ravichandran: So what you are saying is that the product mix is changing towards gold jewellery, which is improving the working capital cycle.

Mehul Choksi: That is correct and that improves generally the entire working capital cycle particularly India.

Ravichandran: But when you come to the segment will you not be competing with other jewellers and will it be harder to retain your branded edge when you are doing gold jewellery?

Mehul Choksi: No not really, we are in fact attracting many more customers. Since we started this, our inquiries for franchise stores have increased sharply and there are stores opening now in the country for 25, 30, 40 Crores rupees too for our brands, so we saw this as an opportunity which we should not miss. You must understand that in every single store in the classic Indian case there is a 15 to 20% diamond sales and 80% gold sales, in our case we will have 40-50% diamond sales and 50% gold sales.

Ravichandran: Will this be the ratio that you hope to maintain going forward?

Mehul Choksi: We hope to maintain the 50:50 ratio.

Ravichandran: Your advertising expenses as a percentage of turnover, can you throw some light on that?

Abhishek Gupta: About 3% of total jewellery sales are for advertisements and promotions which is roughly about 40 Crores for this quarter.

Ravichandran: Will that number roughly be constant? This is what it was last year Sir?

Abhishek Gupta: Well it is normally coming down. As the volume grows it will come down.

Moderator: The next question is from the line of David Thompson (ph) from Pine River. Please go ahead.

David Thompson: Hi there could you just give me an update regarding your talk with L Capital, is that still ongoing?

Mehul Choksi: Well basically we have been restructuring the company and our advisors have advised that you restructure the company and go for a proper valuation that is what the management has decided that we must finish the restructuring exercise and then we will look at the offers that we have on the table. We are not going to decide on anything because we want to look at the best interest of the shareholders.

David Thompson: In the meantime you are not talking to L Capital anymore?

Mehul Choksi: Well, we are in talks with such players but we want to finish the valuation exercise over the next few months.

Moderator: The next question is from the line of Siji Philip from HDFC Securities; please go ahead.

Siji Philip: Have you made any targets for the number of stores, which you would obtain this year?

Abhishek Gupta: We are targeting own stores to grow by around 10%. In FY 2011 we had achieved own stores of 210. As far as franchising is concerned we are expecting an increase of 25 to 30% there. . In shop in shop we have 520 shop in shops and we are expecting a 15% increase in those numbers.

Siji Philip: What is the CapEx you have planned for all this?

Abhishek Gupta: For own stores there will be some CapEx required. And this would not exceed Rs.15 to 20 Crores.

Siji Philip: That you are going to do though internal accruals or any debt on the balance sheet?

Abhishek Gupta: It would be through internal accruals.

Moderator: We have a follow on question from the line of Ravichandran from Prodigy Investment Management.

Ravichandran: Sir can you throw some light on your current levels and how you see these levels moving over the next few quarters?

Sunil Varma: Current net debt level is Rs. 2,700 Crores, which is on a consolidated basis, and 1.03 is the debt equity ratio.

Ravichandran: Do you see debt constant, do you see yourselves needing to take on more debt this year, and how do you see that moving?

Mehul Choksi: No, we are not looking at additional debt this year. We are pretty comfortable for a while.

Ravichandran: Is there any guidance that you give for the fiscal year?

Mehul Choksi: The guidance for the fiscal year is continued expansion at the moment. Of course the commodity prices have also increased. Normally the price increase is followed by the volume, so we are quite bullish about that for the next few months or this year in particular we will have a handsome growth, the kind we have witnessed in the last couple of years.

Moderator: The next question is from the line of Ruchika Gupta from Equity Master?

Ruchika Gupta: I just wanted to know how the prices of diamonds are ascertained, we got to know that last quarter the prices have risen quite substantially and that has helped you post good numbers, so how are they actually ascertained apart from the demand factor?

Mehul Choksi: The volume growth is about 10-15%, the value growth in India is nearly 60%. It increased in last one particular quarter by about 20 to 25%.

Ruchika Gupta: What could have been the reason for such a rise in the last quarter that is what I was coming at?

Mehul Choksi: Not just in the last quarter, but in all of last year, the prices in diamonds probably increased by 50 to 60% . The prices have been constantly going up. There are no new mines and the demand is outstripping the supply, particularly the Asian demand from India and China has been growing at a very fast pace. Apart from Asia, Europe and America are also quite bullish this year. We are seeing a double digit growth this year.

Moderator: There is followup question from Ravichandran from Prodigy Investment Management. Please go ahead.

Ravichandran: Sir given the scenario that you are witnessing in the western world today, would not it be logical to expect that luxury items like jewellery etc., there should be some tapering off in demand what is your view on that?

Mehul Choksi: If you see the very recent numbers particularly organized players like Louis Vuitton or Tiffany, these have shown a good 30-35% growth and most of the growth is coming of course from Asia and luckily even Japan has not done bad after the calamity, it has bounced back strong, so we are seeing a continued growth. We are not likely to see a growth in Europe. Europe plays a very little role because it is a very mature market and the jewellery demand was not increasing more than 2 to 4% for the last 10 or 15 years, so we are seeing a continued demand particularly from the Asian and Arabian markets.

Ravichandran: Is that where your maximum export exposure is?

Mehul Choksi: Our concentration for the last 10 years has been on Asia and Arabia except that we bought a diamond chain in America just because this was completely diamond jewellery, which we were most competent to manufacture, and the entire supply chain was locked in.

Ravichandran: What is the situation in your American subsidiary at the moment, can you throw some light on how you clearly restructured your employee cost etc., is it profitable, what is the situation there?

Abhishek Gupta: This quarter per se we have increased the EBITDA to 6.5% and PAT level about 2.5%, so last year the EBITDA was 2.5%, so we are expecting this EBITDA to grow up to 10% within couple of years

Ravichandran: In US you would imagine that there should be a clear slow down right?

Mehul Choksi: The situation there is that there is a lot of cash in hand as far as Americans are concerned, so it is a very different situation, domestically the demand is increasing as far as jewellery is concerned that is what we have seen continuously day on day, we do not know what will happen in the future but for the last two to three years lot of stores were closed down all over America and probably that is why the chains which are existing have a higher business. In fact our business sales wise is growing at much more than double digit. It is more than 10% at least for the six months in fact continuously.

Ravichandran: But you do see that domestic growth is going to far outstrip export growth.

Mehul Choksi: Absolutely our focus is domestic, in fact we have downsized the chain by about 25 to 30 stores over the last two years in America and that has given us a higher profitability there.

Moderator: The next question is from the line of Atul Pandit from Vantage Securities. Please go ahead.

Atul Pandit: I had just one question, for the branded players like you is there any adverse implication of quoting of PAN which has come up, are you seeing any adverse impact on the volumes because of that?

Mehul Choksi: Luckily it is very favorable for us because most of the items in the brands in modern retail are less than Rs. 5 lakh, so it is quite favorable for us because the competition is little different even in modern jewellery, and also because 95% of our stocks per piece are for Rs.5 lakhs or below.

Moderator: As there are no further questions I would like to hand the floor over to Mr. Sunil Varma for any closing comments.

Sunil Varma: Thank you very much. Thank you all for participating. We look forward to the next conference call.

Moderator: Ladies and gentlemen, on behalf of Gitanjali Gems that concludes the conference. Thank you for joining us. You may now disconnect your lines.