



“Gitanjali Gems Q2 FY 11 Earnings Conference Call”

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**MODERATORS: MR. MEHUL CHOKSI
MR. P.K. DUTTA
MR. SUNIL VARMA
MR. ABHISHEK GUPTA**

Moderator: Ladies and gentlemen, good day and welcome to the Q2 FY 2011 results conference call of Gitanjali Gems. As a reminder, for the duration of this conference, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference, please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now 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 everyone. Welcome to the Q2 and H1 results update. This quarter compared to the same quarter last year, we managed a growth of 43% in sales at a consolidated level. This quarter sale closed at slightly over the Rs. 2500 Cr mark. At EBIDTA level, we managed a significant growth of 44% with Rs. 160 Cr. India remained our key growth market, which increased its contribution from 41% to 47% in this quarter.

For the half year results we achieved a growth of 41% on sales at Rs. 4376 Cr and 53% on EBIDTA at Rs. 315 Cr. EPS stood at Rs. 18.84 over Rs. 11.55 the last comparable half, showing a growth of 63%.

At the operational level, we continue expansion of our retail drive where our key product brands are converting into store brands. We have achieved a penetration across 300 regions in India through our vast distribution network. We now look forward to convert some of the key retailers to franchisee partners as well as continue the expansion drive through setting up new franchisees. We have nearly 15 different formats starting from Rs. 1 Cr to Rs. 25 Cr of investment for our jewelry franchisees. We are looking to develop contemporary and ethnic designs to expand the portfolio in each brand, as well as take them to the international level.

For our international operations, Samuels & Rogers are on the fast recovery path. Due to our in-house supply from India, of 95% of jewelry sold in these stores, we manage to break even at the overall business. We would expect to break even by FY12 at the standalone operations in the United States. With the first wholesale – cum – retail store set up in Dubai, we look forward to expand our presence across Middle East. We would continue to supply to the retailers there and introduce additional gold categories to cater to their likings.

For the increasing retail presence, our current jewelry manufacturing capacity will need additions in the next financial year. We have the option to expand the facilities in Mumbai and Hyderabad SEZ.

In the Lifestyle business we have introduced complementary categories like watches and fashion jewelry to help establish chain stores with core focus on jewelry categories as well as complementary categories as mentioned. We plan to roll out multi format outlets of 25,000 to 30,000 Sq. ft in this segment. Our well established brands command a bargaining power in the current rental markets. We will only expand on revenue sharing model to minimize our capex and opex risks.

In the Infratech segment, booking of our Borivali Residential Project of 3,00,000 sq.ft has already started. We estimate about Rs. 300 Cr of top line and about Rs. 150 Cr of profits on this project.

On the business structure, we are expecting the KPMG report very soon which would help us align our subsidiaries and be visible to all the stakeholders. The objective of this exercise is to measure the performance of each of these streams and have defined business strategies for these respective arms. Thank You.

Moderator: We will now begin the question and answer session. The first question is from Rishi Maheshwari from Enam AMC. Please go ahead.

Rishi Maheshwari: I had a couple of questions regarding diamonds. I noticed that the growth in diamonds has been far more than the growth in jewellery. While the margins in diamond has also exceeded in this quarter by about 80 bps year-on-year now I fail to understand how is that the margins exceeded by about 80 bps and why is that the growth in jewellery has been a laggard, if you could highlight both the things as well as margins in jewellery have come down to about 6.8% as opposed to 8% last year, pointedly those three things.

Abhishek Gupta: Hi, this is Abhishek here, thank you for your question. With regards to diamond growth you know this has been the trend in the last December 2008 when the diamond prices were at it's lowest for last two to three years. From that December 2008 figures it has been consistently growing every quarter close to 18-20% and particularly in the last quarter we had a very good demand from the diamond side as well as the growth in prices, so overall we got a boost in terms of sales and with regards to margins the diamond in particular there is a trend, when the prices go up the margins are better and the sales are better, so we got an opportunity to clear out stock, to clear some of the old orders and we could move the margins as well,

that was on the diamond side. With regards to the question on jewellery we are basically a MRP product jeweler where we revise our prices every quarter and this quarter in particular the raw material cost of diamond as well as gold increased sharply and hence we took a hit in terms of some of the margins that was there. In terms of growth of jewellery 25% was reasonable according to us. We could have done much better in jewellery particularly Q3 is the seasonal best for us and so far in the last two months we have received very good response in the volume and we are looking forward to a very great Christmas, so we are seeing a very rapid ramp up in jewellery in Q3

- Rishi Maheshwari:** Can you break up the price growth and the volume growth in diamond?
- Abhishek Gupta:** In terms of volume it has grown by 25% and the remaining is contributed by the value.
- Rishi Maheshwari:** Can you outline if you have finalized on the structure on how you want to structure the company with regards to diamond jewellery and the other divisions?
- P.K. Dutta:** Actually right at the moment we do not have a very concrete picture to give but yes what we are trying to do is we are trying to carve out some of the brands out of this and maybe we will position it separately, but when I say this, it does not really have any standing at the moment, we are not really running through the board of directors. KPMG is here to give us a concrete report, so hopefully by the next quarter when we possibly have the con-call we should be able to tell you concretely that what is actually in the offing.
- Rishi Maheshwari:** In an article published in ET it was mentioned that you are probably looking at dilution at brand levels as well, so probably Nakshatra, Gili or Asmi can also have private equity placements, is there any concrete understanding to this?
- P.K. Dutta:** No you see the KPMG report was out and there have been a lot of people who have been approaching us. Do not read too much in to this particular article, no great planning at the moment.

- Rishi Maheshwari:** Sir your inventory levels at the end of this quarter would be how many days?
- Abhishek Gupta:** Our overall working capital has come down so if I estimate the sales of the entire year to be around 8500 Crores, overall inventory will be at 31%.
- Rishi Maheshwari:** Are you planning to give out any guidance for the full year?
- Abhishek Gupta:** We might touch 8500 Crores in terms of topline.
- Rishi Maheshwari:** EBITDA would be?
- Abhishek Gupta:** At the moment we cannot exactly commit, but we will remain with slightly better than last year's margins.
- Moderator:** The next question is from Bhavna Jagwani from HDFC Securities. Please go ahead.
- Bhavna Jagwani:** My first question is pertaining to Samuels & Rogers. Could you share with us the loss in this half-year vis-à-vis last year at the EBITDA level?
- Sunil Varma:** We have 18 Crores of loss versus 24 Crores of loss last year.
- Bhavna Jagwani:** Is this at the EBITDA level?
- Sunil Varma:** It is at the EBITDA level.
- Bhavna Jagwani:** And this year we are hopeful to bring down the loss by at least half compared to last year on a full year basis?
- Sunil Varma:** Yes, that is correct.
- Bhavna Jagwani:** Now I understood your explanation on why the diamond business has been growing but does our focus still remain on jewellery, like do we want to shift from being a diamond player more in to the jewellery segment?
- Abhishek Gupta:** Absolutely. For the three-year forecast; the strategy is to take the jewellery business to 70% level in the composite overall business.
- Bhavna Jagwani:** But what will we do about the margins in the jewellery segment because every quarter if we see the type of price rises we have seen in this quarter will the margins continue to fall or will we take price hikes more often?

- P.K. Dutta:** We are pretty acute from what exactly happened. What really happened is we have been revising our MRP every three months, in fact now going forward if we have fluctuations like what we have seen in the last six months possibly we will be doing the MRP revision more frequently than what we have been doing before.
- Bhavna Jagwani:** Okay, if I look at your stand-alone results other expenses is negative and even on year-on-year basis at a consolidated level, it has fallen quite sharply, so could you throw some light on that?
- Sunil Varma:** The other expenditure has fallen because of the exchange rate fluctuations, when the exchange rate appreciated compared to the last year so that is why it offsets other expenditure by this amount and this becomes negative of 7 Crores.
- Bhavna Jagwani:** So, we have had a very big gain in the quarter?
- Sunil Varma:** Yes I think because last year the exchange rate was about 49 rupees to a dollar and this year's exchange rate was around 46 rupees average rate.
- Bhavna Jagwani:** After considering our imports and exports we have had a forex gain in this quarter, which had offset the other expenses at the stand-alone level, and the same applies on the consolidated level.
- Sunil Varma:** This will also be passed on to the consolidated; you can compare the 79 Crores of expenditure in the comparable quarter last year versus 44 Cr in this quarter
- Bhavna Jagwani:** Yes, even if I compare your Q1 other expenses are 124 Crores has come down to 44, so what was the gain that we had this quarter?
- Sunil Varma:** There are three elements in the other expenditure reduction, including for the previous, GGL, Gitanjali Gems stand-alone we had exchange gain of more than 10 Crores and in addition consolidated we also had rationalized our operations in Samuels and rents have reduced, advertising expenses have reduced, so that has also contributed to the reduction over the expenditures.
- Bhavna Jagwani:** So that also from 124 Crores from Q1 has come down to 44 Crores in Q2, so that is a very big reduction quarter-on-quarter?
- Sunil Varma:** That is correct.
- Bhavna Jagwani:** Can you throw some light on your ad expenses in the half-year and where do we see it for the full year?

- Sunil Varma:** Last year it was 103 Crores and we see 5-10% on the high side, not a very high jump in that amount because the reason would be we are also reducing some of the cost in US that will also offset the increase in ad spend in India, so overall I see round about 110 Crores.
- Bhavna Jagwani:** If I look at your geographical break up India has grown very well but the rest of the world is flat?
- Abhishek Gupta:** Actually our key focus is also India, we plan to expand aggressively in to our branded jewellery and the segment in India. Just to elaborate on India we are at the moment very heavily focusing on franchising and retail expansion. We are getting very good traction for the brands that have been established to get in to revenue sharing model in the leading malls here. We see a lot of growth and a lot of potential here at the moment both volume and value wise, both like-to-like and expansion, this is the market where we want to achieve most, in India.
- Bhavna Jagwani:** Yes I understand that. What will be the tax rate be because the tax rate have gone up in this quarter, on a full year basis what are the tax rate we are looking at, what do we fall under?
- Sunil Varma:** The effective tax rate is 14% and you know primarily the India business, the growth in India business will attract more tax, in US we have offset of losses in Samuels and Middle East is not attracting tax, the more we expand in India, we will have some taxes to pay.
- Bhavna Jagwani:** Is that why the tax rate in India has gone up?
- Sunil Varma:** Yes.
- Bhavna Jagwani:** Lastly our inventory levels have also gone up sharply if you look at your balance sheet, so is this because like have we increased our diamond inventory levels or why is this so?
- Sunil Varma:** Inventory, I believe inventory has not grown sharply; in fact it is favorable to us now.
- Bhavna Jagwani:** No I am comparing the amount at the end of March compared to September to this year, that has gone up by about 500 odd Crores?
- Sunil Varma:** Inventory actually overall the working capital has reduced significantly, the inventory build up about 600 Crores probably you will see this is built up for this Q3,

of course for the Diwali season we are building up the inventory, in our retail and our EBO stores across India, so that is why our inventory has gone up.

Bhavna Jagwani: What is the outlook, how are the diamond prices behaving right now and what is the outlook for the next couple of months?

Abhishek Gupta: We just had a meeting with one of the diamond miners and they are very positive. They are starting new mines next year onwards and we are hopeful that prices will establish and have a steady trend of 8-10% growth.

Bhavna Jagwani: Because so far on a year-on-year basis we have seen almost 25% higher realization.

Abhishek Gupta: That was a recovery from the prices, which fell before, but we do see about 5% - 10% increase in the prices in the next quarter.

Bhavna Jagwani: In Q3 on a year-on-year basis 5%?

Sunil Varma: December in particular, December or January we are expecting a 5% increase again.

Bhavna Jagwani: Vis-à-vis which month, last year or this quarter?

Sunil Varma: This quarter.

Bhavna Jagwani: So you see a 5% increase in December versus September of 2010.

Sunil Varma: That is right.

Bhavna Jagwani: Okay, I am done from my side. Your goodwill has fallen a little bit, did we do some write off at the US level?

Abhishek Gupta: Yes we did because we are gearing up towards the IFRS compliance especially in the Samuels we do not see the goodwill will have to be taken off the books; yes we took the write off on the goodwill in this quarter.

Bhavna Jagwani: This has come under what head?

Sunil Varma: This has come under depreciation amount.

Bhavna Jagwani: So, can we expect this every quarter?

- Sunil Varma:** No this has cleared, the goodwill for Samuels, but then we would also be basically taking some of the write ups because we are gearing towards the IFRS. We are also looking at the goodwill in other entities and we will be also taking some of the write up, so that before March 2011 we comply with IFRS.
- Sunil Varma:** Yes, but it will not be a significant amount, in this quarter all the amount of goodwill was...
- Bhavna Jagwani:** What was the amount this quarter?
- Sunil Varma:** This quarter was about 10 Crores.
- Bhavna Jagwani:** And you are saying this reflects on the depreciation.
- Bhavna Jagwani:** Yes, the overall number for the quarter was 18.4 Crores.
- Moderator:** The next question is from Shobhankar Ojha from SKS Capital. Please go ahead.
- Shobhankar Ojha:** How much fluctuation in gold prices affects our business, I understand that gold is at 1300 USD, but the demand of jewellery may be little lower than, I do not understand properly if you can give me a little idea?
- Abhishek Gupta:** We sell all of our diamond jewellery on MRP basis. The MRP is fixed at the time of manufacturing itself and if the prices of diamond and gold go up the MRP is revised every quarter.
- Shobhankar Ojha:** So you do not have the risk of prices going up because you are revising on a quarterly basis?
- Abhishek Gupta:** That is the difference between a traditional jeweller and a branded jeweller like our business.
- Moderator:** The next question is from Percy Panthaki from HSBC. Please go ahead.
- Percy Panthaki:** Hi, my question is on the international business front, just a few minutes back you said that the main focus of the business is going to be on the Indian portion but we are also seeing that Gitanjali is interested in acquiring new and new businesses in places like Italy etc., so can you just throw some light on what exactly is the focus?
- P.K. Dutta:** Percy, it is not so much of we are going to do international business. Well we are talking about acquiring some foreign brands that could be possibly coming in the

future but what we want to acquire is the technological know how which comes with the brands. Many of these particular brands make ornaments or jewellery which caters to the western taste. US is one such market where we can actually boost our sales through manufacturing and lowering the cost of manufacturing the same product which is being made in Europe. We make it in our Chinese factory or in India, so it is largely seen from that particular point of view where we get a technological edge and which is not available right at the moment in India or even in China as a matter of fact and it could be extremely good. Since it is a very lightweight jewellery which is not made in India. With the prices shooting up as is with gold, possibly a time will come when the lightweight jewellery will also be extremely popular in India. So we are taking a step forward to bring this technology in to India and with that intention we are looking in to all these acquisitions.

Percy Panthaki: But Sir, do you really have to acquire the whole company just for the sake of technology, is not there any other way to acquire the technology?

P.K. Dutta: No I will tell you one thing, it is very difficult because with the technology comes the design, and the technology and the designs are very intricately connected. You can have the technology, you may know how to possibly manufacture it but the designs which are actually suitable for this kind of technology is not available, so that comes with that. If you look exactly in to how we are procuring, we are not procuring the company, we are just procuring some assets which include the IPR, some machinery and some stocks. So we are actually not acquiring the company as such.

Percy Panthaki: So you are not acquiring any of the liabilities?

P.K. Dutta: No we are not acquiring liabilities, we are just acquiring, because these companies are already in to some kind of a what they call in the Italian language as 'concordtto' which means kind of liquidation or a preliquidation process, so we are not acquiring any of those liabilities, we are not taking any bank line, we are not even taking on any assets like building or anything of that sort we are just taking the stocks, we are taking the IPR of the brands and we are taking some machineries and some people who are adept at this technological know how.

Percy Panthaki: You are not acquiring any store frontage or anything like that?

P.K. Dutta: Nothing absolutely, of course with this is also some of the people that were buying in Russia; you know this brand that we are trying to acquire in Italy was extremely

popular in Russia and some parts of Europe, so it comes with a fixed clientele as well.

Percy Panthaki: If you are not acquiring any store frontage then what is the means by which you will sell this particular brand in that particular market in which it is present?

P.K. Dutta: Distributors.

Percy Panthaki: Secondly just wanted to understand on your jewellery margins you said that mainly it is on account of the gold price inflation, so has a price increase already been taken and if so can you give me the details of the price increase or if it has not been taken any idea on when you would be taking it and also with these steps what kind of margins do we expect in the second half of the year on jewellery?

P.K. Dutta: Percy on a ballpark basis you know we have already taken a 10% increase on the MRP for most of the products and in the third quarter with the sales that we have seen during the festive season we should expect the EBITDA to be increasing by at least 0.5 to 0.6%.

Percy Panthaki: Margins?

P.K. Dutta: Yes, you can say that, the margins possibly will increase by close to 1%.

Percy Panthaki: Okay, so you are saying from 6.8 it might go to somewhere around 7.8.

P.K. Dutta: 6.8 I think is the EBITDA, 6.8 might come to 7.3.

Percy Panthaki: That increase is actually quite small because earlier you had posted margins in the region of 8.5-9% also.

P.K. Dutta: Look this is what I am talking to you as it happened in the last 15-20 days time, and this is the total thing which I am talking about now and our US thing is on and I think that will contribute very heavily to this because November 15 to November 25 has been one of the most significant period of sales in US and then comes for the Christmas which is in December, so this quarter possibly we are giving a very conservative figure, if our expectations are met in US then possibly you could be somewhere close to the figure that you have mentioned.

Moderator: The next question is from Rishi Maheshwari from Enam AMC. Please go ahead.

- Rishi Maheshwari:** Hi, just testing your conservatism again because if I am correct Mr. Choksi had come on air and he has mentioned that at a consolidated level you are aiming to grow by 50% this year, am I right or have I misread it?
- Abhishek Gupta:** 50% primarily in Indian jewellery business.
- Rishi Maheshwari:** So, overall we are looking at 30% kind of thing. The next just a couple of book keeping, how the debtor day is shaping up, the DSO?
- Sunil Varma:** Currently if we take the debtor amount it is 3874 Crores and if you take it as overall sale basis which we were projecting at 8500 Crores it is coming to 46% which has significantly reduced from our March figure as well as our last September figure.
- Rishi Maheshwari:** I agree but I was just wondering whether the first half for your entire working capital cycle is very heavy and it will probably get realized in the second half.
- Sunil Varma:** Yes, inventory and debtor both will get realized, inventory will be light because they are expanding in retail so inventory might emulate the same days but debtor days will come down significantly. It has already come down compared to last quarter in last year.
- Rishi Maheshwari:** Okay and what is the kind of CapEx that we will involve for FY 2011 and FY 2012?
- Sunil Varma:** FY 2011 we are looking at 25-30 Crores max and FY 2012 it could be around 50 Crores.
- Moderator:** The next question is from Abhishek Soni from Canara Robeco Mutual Fund. Please go ahead.
- Abhishek Soni:** Just wanted to understand a bit on how the current distribution system is like is it more of a franchisee basis or company owned stores and how is it going to change over the period, is it going to change?
- Abhishek Gupta:** As far as retail is concerned in India we have four different channels, one is the distribution network which is the largest followed by franchisee, followed by shop in shop followed by company owned company operated stores. Owned stores and franchisee stores at the moment are doing neck to neck in terms of revenues but we see that franchisee revenues would double in the next two years and own stores we will have to create some more flagship stores which will help us in attracting more and more franchisees, so own stores we are looking at a growth of 25-30% in the next two years.

- Abhishek Soni:** In terms of franchisees we are looking to double?
- Abhishek Gupta:** We are looking to double in the next two years.
- Abhishek Soni:** How in terms of franchisee the profit sharing model works?
- Abhishek Gupta:** We have different formats as Sunil started with his presentation we have formats ranging from 1 Crores to 25 Crores and we share in diamond jewellery we share our 25% to 26% with the franchisee partner.
- Moderator:** The next question is from Jayesh Gandhi from Morgan Stanley, please go ahead.
- Jayesh Gandhi:** Very quickly on the jewellery business I heard somebody suggested that you are looking at 50% growth that is India business which is around 1800-2000 Crores of sales?
- Abhishek Gupta:** That is correct Jayesh.
- Jayesh Gandhi:** Okay and how did it happen in the sense if you were to break that up into various brands that you have which are the faster growing brands or are there some which are growing much faster than the rest or is it spread across?
- Abhishek Gupta:** We have Gili, Nakshatra and Asmi and Fantasy(which has the Maya brand), these are the four brands which are going at equal pace of close to 50-55% and D'damas is about 40% and that is how the aggregate comes to close to 50%
- Jayesh Gandhi:** And 50% growth is in this year that is FY 2011, okay and if you were to take a longer-term period what kind of growth rate you can sustain?
- Abhishek Gupta:** Next five years time we are expecting a CAGR of 30%.
- Jayesh Gandhi:** You did mention in the last answer that franchisee you are looking to grow 100% but franchisees have 200 odd Crores of sales right?
- Abhishek Gupta:** Number of franchisees is 215, the sales is also close to 220 Crores that is correct.
- Jayesh Gandhi:** If your sales are going to double then most of the growth has to come from your distributors?
- Abhishek Gupta:** Distributors are growing at a steady pace of 20-25% and franchisee will grow at 100% in the next few years.

- Jayesh Gandhi:** What about own shops?
- Abhishek Gupta:** Own shops we are looking at a growth of 30-35%, when I say percent it is combines both volume and value, there will be an inflation component of 10-12% in this.
- Jayesh Gandhi:** I guess what I was not able to understand is that how can you achieve 50% growth in jewellery sales if your overall franchisee distributors which is 50% of your sales grows only at 20%, I was unable to understand?
- Abhishek Gupta:** Jayesh, just to elaborate on the qualitative part we have identified 600 regions in India where branded jewellery can be sold and so far the penetration is about 300 regions, so we have a scope but our strategy is to grow at a steady pace of 25% a year and when I say distributor of 35% growth it will have volume as well as value growth, so like-to-like distributor are growing faster and there will be additional distributor added every year.
- Jayesh Gandhi:** Do you give financial disclosure for jewellery group in terms of margins and in terms of balance sheet etc., working capital etc.?
- Abhishek Gupta:** At that moment it is only two division's jewellery and diamond at P&L level but overall we have not segregated.
- P.K. Dutta:** That is why you know one of the reasons that maybe going forward we want to bring in more transparency and that is why this KPMG that what you have been talking about is restructuring. Going forward may be in near future, one could get a glimpse or a total thing of the jewellery sector separately, the diamond sector separately and rest of it separate. We are attempting that.
- Jayesh Gandhi:** You did mention that there was some losses in the US business Samuels & Rogers business, what about Dubai business, is there a loss there as well?
- P.K. Dutta:** Dubai is actually Middle East, Dubai is only the hub but actually we do business all over the Middle East and Dubai is the distribution center. Dubai is one of our most profitable areas and going forward it will be a good growth area. We have just opened our first retail store in Dubai in the gold souk which actually was opened in July and we have already seen a very significant growth from that particular shop. So Dubai we are making good money.
- Jayesh Gandhi:** My sense is that exports also from India would be profitable which is part of the jewellery group.

P.K. Dutta: Yes. Certainly.

Moderator: As there are no further questions from the participants I will now like to hand over the conference back to Mr. Sunil Varma for closing comments.

Sunil Varma: Thank you gentlemen for joining us for this conference call and anytime any of you want to know anything just feel free to contact us on one to one basis at any point in time and we will be extremely happy to be in touch with you. Thank you very much again for joining us.

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