“Gitanjali Gems Limited”

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MODERATORS: MR. SUNIL VARMA
MR. ABHISHEK GUPTA

Moderator: Ladies and gentlemen good day and welcome to the Gitanjali Gems Limited Q2 FY'12 results conference call. As a reminder all participants' line will be in the listen only mode. There would be an opportunity for you to ask question at the end of today's presentation. If you should need any assistance during the 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, thank you and over to you Mr. Varma.

Sunil Varma: Good evening ladies and gentleman. Welcome to the financial release of Gitanjali Gems for the quarter ended 30th September, 2011.

This quarter has absorbed significant fluctuation and increment in prices of gold. Accounting that, Gitanjali has achieved exceptional jewellery sales during this period in India. India as a geography and jewellery as a category have been the major drivers for this quarter. Gitanjali achieved net sales of Rs. 3,168 crore for the quarter ended September 30th, 2011, as compared to Rs. 2,510 crore in the corresponding quarter of last fiscal year, registering a growth of 26%., with the jewellery segment growing at 39%. During the quarter the group has also registered Net Profit of Rs. 132 crore, grown by 65 %, as compared to Rs. 80 crore posted in the same quarter of last fiscal year. Earnings per share stood at Rs. 15.5 as compared to Rs. 9.5 in the corresponding quarter. The EBITDA margin for the quarter was at 7%, as against 6.4% in the corresponding quarter, registering a growth of 38%.

For the half year ended on 30th September, Gitanjali achieved sales of Rs. 5,763 crores, as compared to Rs. 4,376 crore last year, registering a growth of 32%. Net profit for H1-FY12 was at Rs.255 crore, as compared to Rs. 159 crore in H1-FY11, registering a growth of 60.9%. EPS for H1-FY12 stood at 30.03, as compared to Rs. 18.84 in H1-FY11.

Our integrated business model is unique in the world. It's a combination of sourcing strength with economies of scale in manufacturing, coupled with branding to offer maximum value generation potential in the jewellery category. As our brands are becoming national chain stores, with this business model we aim to become the largest player in the luxury space globally. The momentum in Tier II and Tier III towns in Indian market has been the biggest contributor to this growth. Besides we are also looking at a huge potential to unlock value from our Indian branded jewellery business. Recent valuation exercise valued the Indian brands over Rs. 5,500 crores. We are working towards unlocking this value for our stakeholders.

India continues to excite us with opportunities. First half has seen substantial growth in franchise business. Not only have stores been opened in cities like Mumbai, Delhi and Bangalore but we have traction from small towns like Satna, Aizawl, Kottayam, Hospet, Dibrugarh to name a few. Gitanjali has been positioned as brand capital for jewellery in India. Innovation is the key attribute to our company's expansion plans. We have developed multi brand formats like Jewel Souk, Maya Jewels and taken initiatives like gold and jewellery ATM to spread our categories. Besides the transformation from product brands to retail chains, we have seen a surge in demand for our gold jewellery collections. We have introduced various designs in this category to remain as preferred jeweler to the consumers in this segment too.

First half of financial year 2012 has also been significant for our restructuring activity. We are pleased to announce the completion of restructuring of Indian subsidiaries. The international subsidiaries are also expected to be structured within 2-3 months. We have further reduced the net working capital to sales ratio from 47% in FY 11 to 40% in H1 this year. This has helped in sustaining the borrowings.

On the international front, our USA retail chain has significantly grown, both in terms of sales and profitability. We expect an overall jump in profitability due to this. Our operations in the Middle East and Far East have also increased their width to reach more chains and jewellery stores. Italian brands are also establishing their flagship store in China under “La Nouvelle Bague” and “Stefan Hafner” boutique stores. These brands are targeted to cater to the Chinese demand for luxury and further tap the Russian and Arabian markets soon. Our strategy is to focus on emerging markets to drive growth for the jewellery segment. With integrated business model and branded jewellery play we are confident to expand the top line and achieve even higher bottom line. Thank you!!

Moderator: Thank you very much Mr. Varma. We will now begin the question and answer session. The first question comes from the line of Ravi Chadha from Prodigy. Please go ahead.

Ravi Chadha: Good evening and congratulations on good numbers. While you have always said and one knows that gold is a pass through in terms of the profitability of the jewelry segment, yet can you confirm that given the gold prices did so well, there were no inventory gains or anything in that? Should one assume that this has come through better product mix in the jewelry segment? What accounts for the fact that the profitability of the jewelry segment has grown far ahead of top line?

Abhishek Gupta: Ravi, the jewelry segment mix has changed, from diamond to jewelry and gold is borrowed and the prices are booked on the day it is sold. So there is no inventory gain as far as gold jewelry is concerned.

Ravi Chadha: So one should assume that this is through better mix and through a leverage on whatever fixed cost you had?

Abhishek Gupta: The gold is un-hedged as far as finished jewelry in diamond is concerned, but at the same time in diamonds we have profits on one side while on the other side the prices of diamond also increase through the year and we sell this at MRP. So there is no significant change for profits.

Ravi Chadha: Okay and do you see the momentum continuing in H2 in the jewelry segment?

Mehul Choksi: Now, basically the market is growing this year by 10% or so in terms of volume. And value wise it is growing by about 40% but basically our brands are very well established and all the brands are becoming very popular. As far as jewelry is concerned, previously they were just product brands and now we are changing them to a complete jeweler, offering of a complete jeweler. So, this is the momentum, which is really trailing the growth.

Ravi Chadha: Can you throw some light on what you mean by the statement that you are moving away from product brands to retail chain?

Mehul Choksi: Generally when we started off all these collections, they were more of product brands, they were mostly in the Shop in Shop concept say five to seven years before. Once they were established for two to three years, they have become famous brands and they are reckoned as a jeweler. So we are establishing jewelry stores, a chain store where apart from the product brand different offerings like gold jewelry are available just like a full fledged jeweler.

Ravi Chadha: So, when you say you have opened 61 stores, and added nearly 270 retailers to the distribution. So can you just give a sense as to how many were added under which brand?

Abhishek Gupta: It's a mix of all the brands, Ravi. I think each of the brands has probably 7 to 10 stores opening and apart from this, we also have multibranded store formats like Maya Jewelry, Gitanjali Jewels and Jewel Souk, so these are also expanding. Each one of them has probably established about five to seven stores as a multibrand outlets and these have investments of anything between Rs.5 to Rs.15 Crore. The latest store opened was in Chandigarh with an investment of nearly Rs.15 Crore in the store.

Ravi Chadha: So this is own a Franchised?

Mehul Choksi: It is a Franchised store.

Ravi Chadha: So the Franchises invested as much as Rs.15 Crores.

Mehul Choksi: Yes franchises invest up to Rs.15 Crores. In a multi branded store that is the offering. We normally offer the store between Rs.5 to Rs.15 Crores investment according to the area, according to the consumption we feel that it could generate.

Ravi Chadha: So can you just give us a sense as to how this Franchisee model works, how much does the franchisee put in and how much do you put in and what kind of royalty is involved, etc?

Mehul Choksi: Basically it works on a different model. In Diamond jewelry we offer them as much as 26% whereas in the gold jewelry we offer them some thing like 4% to 5% while in coins its different and probably in other jewelry its still different. Hence it differs segment wise. Basically the return on investment is anything between 15% and 18% what they target. Of course in the last couple of years they made more money because gold prices and diamond prices have changed. So they probably made much more money.

Ravi Chadha: Can you give us a sense in any Franchise that you opened last year also left your network since we have only adds, I presume it is only net adds have you lost any Franchisee?

Mehul Choksi: No, we have lost one in Jammu & Kashmir, Jammu where the partners split so we lost that particular Franchise.

Ravi Chadha: Okay but otherwise you haven't had any Franchises leave the network?

Mehul Choksi: No. Also we discontinued one Franchise in Delhi who was also trying to sell its own merchandise in jewelry and since we have a very strong audit team which goes out in the market to check on such activities we have had discontinue the one in Rajouri garden.

Ravi Chadha: So in this case if a new Franchise has invested Rs. 15 Crore, now would it be on consignment to be sold? How was it done? Was it billed to him the moment it goes out?

Mehul Choksi: We have three systems. Mostly it's a 50% or more on confirm sale basis. There could be some Franchise we call it COFO, COFO is the company owned and franchise operated and some times the franchise owned merchandise in company operated. So there are three systems basically. One Franchise is called FOFO, and Franchise owned and Franchise operated, company owned and franchise operated and franchise owned and company operated. There are three different systems and the percentage of revenue share differs according to each model.

Ravi Chadha: Okay and can you give us the same circle how many more stores a Franchise might open in the coming quarter half year?

Mehul Choksi: We are expecting that Nakshtra, Asmi and Gilli and as far as my major brands are concerned these three, by March could add up another ten stores each or so. While Gitanjali Jewels and Maya Jewels will be adding up another ten stores. Jewel Souk is basically at this moment not Franchising but we are opening our own stores and they are again expecting to open another ten to fifteen stores. Diya jewelry has about 3 to 4 stores adding up.

Ravi Chadha: Can you just give a sense as to in this first half how much has been your investment in your stores and how much would be your investment in your stores, Franchises etc, in the second half?

Mehul Choksi: I can give a ballpark figure. Out of these, maybe 50% is our investment in stores and 50% is a Franchises investment.

Ravi Chadha: If you could quantify that?

Abhishek Gupta: In terms of Capex you mean to say? Capex is in the tune of about Rs.8 to Rs.10 Crores. We are not talking about operating inventory we are talking about Capex.

Ravi Chadha: Can you just give a sense as to your plans in China what kind of investment this could involve and what is the kind of products that you would be introducing there?

Mehul Choksi: China basically we are supporting one particular unit there which has 50 stores and we have been working with this company for more than 5 to 6 years and basically we plan to upgrade that particular unit and take over the unit and we have had discussions on that and we want to expand these on a Franchise basis further. At the moment they are all shop-in-shop in Malls so we are going to upgrade to become street stores as well as Mall shops and we want to Franchise further.

Ravi Chadha: And could you give in a sense is this some thing significant in a year-to-year business what kind of size you are looking at?

Mehul Choksi: At the moment in a year or two we do not intend to invest too much money. Once we have a successful model then we will think about expanding it.

Ravi Chadha: Okay great if I have any more question I will join the queue.

Moderator: Thank you very much sir. The next question comes from the line of Laxmi Deepak from MAPE Securities. Please go ahead.

Laxmi Deepak: Hi good evening. Just wanted to ask what’s your experience been with selling gold jewelry obviously in Diamond Jewelry you were the pioneers where as in gold jewelry there is so much of competition so how are you responding differently and behaving differently when it comes to gold jewelry.

Mehul Choksi: Extremely encouraging, its very, very promising much above our expectations both, as a product brand and as well as in our own stores both the places we are extremely happy because as far as Gitanjali’s image is concerned it gives a guaranteed product which matters a lot in gold. So all the brands and apart from that our own product brands like Maya Jewelry are doing extremely well, fairing much above our expectations. We are also suppliers to some of the leading chains in the country in the capacity of a product brand.

Laxmi Deepak: Okay can I just ask you, you said that this year you see volumes actually going up 10% whereas you know most of your competitors including big and branded players are actually seeing volumes that’s actually declining especially the Diwali was quite bad according to most people but that has not been your experience if you can just talk about why is it different for you?

Mehul Choksi: The like-to-like stores have not seen a great volume growth. Probably some of the stores sales have been flat. Its more because our brands are very strong and it is more coming from width where we are increasing the number of stores. We are increasing the clients, and, the distribution and franchise model. Because of the brand name, we are expanding into second and third tier towns and also in other cities. That is the main reason for our growth in volume.

Abhishek Gupta: The additional volumes are coming from the expansion that we are doing in franchise, own stores and Shopper Stops. In like-to-like stores on an average some are doing 15% and some are doing 12% on an average like-to-like is around 8% to 10%. It is flat.

Laxmi Deepak: Just to continue on the gross margin front you have expanded margins I mean could you just explain how that has happened?

Abhishek Gupta: It is the product mix Deepak. We have more of jewelry we have more of retail and we have more of franchise and own store so it's a product mix as well as the channel mix which has helped us get better margins.

Mehul Choksi: Another reason for better margins is that some of the Diamond inventory we review the prices every three months that we have been reviewing the prices there that has also helped partly and going forward we expect the margin to continue better you know due to the change in mix and the change in product category.

Laxmi Deepak: Even at the operating level obviously your jewelry margins have expanded partly because of the improvement in the US business but just talking about the India business what kind of margins are you looking at like in that?

Abhishek Gupta: In India the jewelry margins at the EBITDA level for this particular half year were about 15%.

Laxmi Deepak: Can I also check with you what is the India growth for the quarter?

Abhishek Gupta: India growth was in the range of 61%.

Laxmi Deepak: Just wanted to check your other expenses are quite high in the quarter, if you can just give me some clarity on that?

Sunil Varma: Other expenditure if you compare with the previous year, the difference is only because of the exchange gain and loss, so if you compare year on year there has not been an increase as such in other expenses.

Laxmi Deepak: Can I check what is your likely tax rate going to be for the year?

Mehul Choksi: It is going to be in the range of about 21% to 22%.

Laxmi Deepak: Finally just from the balance sheet I have seen that the goodwill has actually come down, could you tell me why that has happened?

Sunil Varma: The goodwill if you compare with last year, we have some goodwill in Samuels which we took write off in the H1 last year, for FY'11 that is why last year it was higher and we have taken a write off in that year.

Laxmi Deepak: Of course we have not taken money for two years is that the reason?

Sunil Varma: To some extent goodwill, write off there is no goodwill remaining there.

Laxmi Deepak: My last question is debtors basically rising slightly faster than revenue with this economic downturn in the US and Europe do you see any risk like 2008-2009 kind of playing out that you might be stuck with a lot of inventory?

Mehul Choksi: Not really, we are not working with Europe too much and as far as America is concerned we are seeing much better result, just to tell you that this month America is showing a 50% growth it is unbelievable the kind of retail growth there is in America, so basically we are expecting much better result - given our supply, but at a retail level in Jewelry this category is doing extremely well.

Laxmi Deepak: Okay thank you so much.

Moderator: Thank you very much Sir. The next question comes from the line of Prashant Kutty from Emkay Global. Please go ahead.

Prashant Kutty: Good evening sir and congratulations on good set of numbers, sir one question I want to ask is regarding the volume, what is the volume growth in H1 for the Indian segment?

Mehul Choksi: We have seen a volume growth of about 23% Indian jewelry here.

Prashant Kutty: What will it be for others excluding US?

Mehul Choksi: For US also there is a volume growth because price point unit wise we have gone down in US and because of that we have seen a volume growth of about 7% to 8% for H1.

Prashant Kutty: What would it be for the other international markets excluding US?

Abhishek Gupta: We are talking volume, not value.

Prashant Kutty: Just to ask about the international market excluding the US?

Abhishek Gupta: Overall for the entire international market our growth has been about 35% to 40%, value growth.

Prashant Kutty: What would it be volume wise sir?

Abhishek Gupta: Basically it will represent about 10% growth in volume as far as international business is concerned.

Prashant Kutty: Do we see this number to be sustainable especially if we are talking about 23% growth in volumes for H1, do we see this number to be sustainable in the next two years?

Mehul Choksi: We have two major avenues that we have begun selling this year one is the gold jewelry selling much more aggressively and apart from this our brands being established, we have a width coming in, we are increasing our number of stores and you must have seen the advertisement for franchises and distributors everyday and this is what we are penetrating heavily into and that is where we see the growth path. If the value of the product increases we may not be able to sustain the like-to-like store for the volume, but width will increase our business volume.

Prashant Kutty: What was the advertisement cost for the quarter sir?

Abhishek Gupta: The advertisement cost was about Rs. 20 Crores.

Prashant Kutty: This was vis-à-vis how much in the last quarter or same year last quarter.

Mehul Choksi: Rs. 16-17 Crores.

Prashant Kutty: This is expected to be roughly the spend for the year as well?

Mehul Choksi: We will see a growth of about 20% to 25% in the ad budget.

Prashant Kutty: Thank you sir, I will come back if I have any questions.

Moderator: The next question comes from the line of Ravi Chadha from Prodigy. Please go ahead.

Ravi Chadha: Just wanted to get a sense that if you see at some level of gold price there would be some resistance and your volumes could actually taper off, is there anything that you think can happen?

Mehul Choksi: Basically we are one of the largest supplier of gold to many of the jewelers including Middle East and we are seeing value growth, but of course volume wise in gold jewelry we have expanded only by 10% to 12% this year and it will continue. I believe in imports we would show 15% additional gold come in this year, so 900 tonnes is going to go up to nearly 1050 tonnes this year, so we will see the growth therein. As far as my brands are concerned, most of my brands have added gold as a category only this year, so we are seeing expansion because of our brands.

Ravi Chadha: If you were to break this volume growth at 23% between your Tier 1, 2 and 3, what has been your sense how much of the growth is actually from tier 2 and tier 3?

Abhishek Gupta: The volume growth in tier 2 and tier 3 will be more than 30% to 35% .

Ravi Chadha: Approximately how much of your revenue comes from tier 2 and tier 3 this point?

Mehul Choksi: At this point, about 25% to 30%, comes from Tier 2 and 3 towns and that is growing at a very fast pace.

Ravi Chadha: End of the year, what do you think this mix will be between Tier 1 and Tier 2?

Mehul Choksi: It will increase from 25% to 30%; we expect that two years down the line it could be 50-50. Like we have opened shops in towns like Aizawl, Kottayam, Hospet, etc. which is probably very surprising because we are on national Television, many of the small towns have been able to accept us as a jeweler.

Ravi Chadha: Do you see the percentage of your expenses remaining constant, going up, going down?

Abhishek Gupta: **P**ercentage wise it will go down.

Ravi Chadha: Thank you.

Moderator: Thank you very much. The next question comes from the line of Jayesh Gandhi from Morgan Stanley. Please go ahead.

Jayesh Gandhi: Good afternoon gentlemen. Couple of questions from my side. I was wondering in the first half we have done around 300 Crores of jewelry sales that is what the segmental results are showing. Would you be able to break this down into how much is branded, how much is jewelry sold to the jeweler in an unbranded form etc?

Mehul Choksi: We should have about 25% as unbranded, 75% as the branded.

Jayesh Gandhi: I do not know whether you give broad breakup into your various brands Asmi, etc?

Mehul Choksi: Well Asmi, Gili and Nakshatra. These three brands have done approximately 500 Crores of business in the first half.

Jayesh Gandhi: How would that pack up?

Abhishek Gupta: 500 Crores of each.

Jayesh Gandhi: So 1500 Crores versus last year number?

Abhishek Gupta: It is an approximately 35% jump from last year.

Jayesh Gandhi: What will be the balance; you gave me the breakup 1500 and 500?

Mehul Choksi: We have many more brands. These are the leading brands that I am talking about. Maya Jewelry, being gold jewelry has done nearly a 900 Crore of business.

Abhishek Gupta: Out of 3,000 crores of jewellery sales Jayesh around 2,000 crores is coming from the Indian brands, 500 crores is coming from unbranded and 500 crores is coming from international brands and other international subsidiaries.

Jayesh Gandhi: Fair enough. You earlier, I guess in the call you commented that your working capital has come down and I was wondering how because the figures that I have suggesting it have gone up year-on-year, so may be if you can clarify?

Abhishek Gupta: The net working capital to sales ratio has come down, I have annualised the sales and this year we are expecting sales in the north of 12,500 crores and if you take today's net working capital it would be roughly about 40% of that number.

Jayesh Gandhi: So as a percentage of sales it has come down?

Abhishek Gupta: In absolute terms it has increased.

Jayesh Gandhi: As the company is undertaking some restructuring could you briefly explain to me what is the objective and to what extent have we achieved or completed the process?

Mehul Choksi: Basically when we went for IPO five years before we were more a diamond company so only about 15% of our business was jewelry and branded. Today nearly 55% is our jewelry business and 45% is the diamond business. So basically we are trying to unlock value and we are trying to increase the value for stakeholders. Sometimes the investors consider us a diamond and sometimes a jewelry player, while other times, they consider us a retailer. Instead of this KPMG advised us that we should divide the company into particular categories so anybody who wants to invest into that particular category will be able to do so and that we would receive a fair multiple. So we are dividing the business into three major structures, one is going to be the manufacturing company, manufacturing gold and diamond jewelry which is our parent company Gitanjali Gems, then Gitanjali brands limited, a subsidiary of Gitanjali Gems Limited, is going to be a holding company for all our brands. This company will have the branded business and retail business India and we are clubbing all our international business which is the American business, Middle East business and also Italian business and whatever business they are doing, into one company in Hong Kong as a third subsidiary.

Jayesh Gandhi: Is there a plan to list these three companies separately?

Mehul Choksi: As yet, there is no such plan made At the moment we are trying to finish the entire restructuring exercise and as the time goes and as we see the growth and our capital needs of course, we are little averse to take on more debt and we are more averse to take on liquidity, so it will depend on how we go further, and how this will develop further.

Jayesh Gandhi: So objective of the restructuring exercise is to separate out the divisions, which have a separate model, I guess?

Mehul Choksi: We feel very strongly once we do it the multiple will change totally because it is very clear to identify where the investor is investing.

Jayesh Gandhi: Finally, I guess I wanted some color on the debt, the debt has also gone up quite a bit on the consolidated side, so may be you can give some color on how much is the short term, long term and I believe there are some FCCB also so how is the overall situation?

Mehul Choksi: Most of the debt , almost 95% is a working capital debt and only 5%-7% remaining is the long term debt, which is FCCB, which is now outstanding less than 35% from our original issuance and another one was for the SEZ. So basically nearly Rs.180 Crores is the outstanding debt as far as the long term is concerned. The rest is only the working capital and is mainly because of the business cycle, the overall business numbers have increased tremendously. What we are enjoying is 1 to 0.8; the debt is only 0.8 to capital.

Jayesh Gandhi: Right thank you Sir.

Moderator: Thank you very much Mr. Gandhi. The next question comes from the line of Deepa Mirchandani from UBS. Please go ahead.

Deepa Mirchandani: Just wanted to understand what is the same store sales growth when you talk about the 20-23% volume growth in the Indian jewelry business?

Mehul Choksi: Value wise the same store sales growth is nearly 45%, in volume it is an average of 5 to 10%.

Deepa Mirchandani: Okay great thank you so much sir.

Moderator: Thank you very much. As there are no further questions right now I would like to hand the floor back to Mr. Sunil Varma for any closing comments?

Sunil Varma: Thank you very much for attending the conference call, we will see you again in the month of February for the next conference call for the Q3. Thank you very much.

Moderator: Thank you very much sir. On behalf of Gitanjali Gems Limited that concludes this conference call. Thank you for joining us. You may now disconnect your lines.