



"Gitanjali Gems Q3 FY11 Earnings Conference Call"

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

Moderator: Ladies and gentlemen, good evening and welcome to the Q3 FY 2011 Earnings Conference Call of Gitanjali Gems Limited. As a reminder, for the duration of the conference, all participant lines are 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 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 the Gitanjali management. Thank you and over to you.

Sunil Varma: Good evening everybody, I am Sunil Varma from Gitanjali Gems, CFO. Welcome to the conference call for the Q3 results of Gitanjali Gems for FY 2011. Welcome to yet another milestone of results achieved in the third quarter of financial year 2011. This quarter has been significant in terms of profitability, good working capital efficiency and cost control. We have achieved net sales of Rs. 2,654 Crores for the quarter as compared to Rs. 1,812 Crores in the corresponding quarter last fiscal year, registering a growth of 46%. During the quarter the group has registered a net profit of Rs. 101 Crores a growth of 147% as compared to 41 Crores posted in the same quarter last year. Earnings per share stood at Rs. 11.9 per share as compared to Rs. 4.8 per share in the corresponding quarter. The EBITDA margin for the quarter was at 6.8% as against 5.6% in the last year same quarter. The EBITDA expanded by 120 basis points.

For the nine months ended December 31, 2010 revenues stood at Rs.7,030 Crores registering a growth of 43% as compared to Rs. 4,922 Crores in the corresponding period of the last year. Net profit for nine months of FY 2011 was at Rs. 262 Crores as compared to Rs. 141 Crores in the nine months of FY 2010 registering a growth of 86%; EPS for the nine months of FY 2011 stood at Rs. 30.77 as compared to Rs. 16.45 in nine months of FY 2010.

Indian jewellery demand continues to drive the business for the group. With retail expansion we are able to reach directly to our customers and strengthen our brand portfolio.

Speaking of the major developments that took place during the nine months ended December 31, 2010 of the financial year 2011,

The volume growth was driven primarily by the Indian branded jewellery.

The Indian branded jewellery sales were a major driver for the jewellery growth.

Gili, Asmi, Nakshatra, D'Damas are converting into retail chain stores. Further these brands are penetrating into tier 2 and tier 3 towns through the franchisee route.

In addition to diamond jewellery, the strategy is also to offer more choice to consumers by focusing on gold jewellery in the near term.

Gitanjali's share in modern retail format of jewellery is nearly 65 to 70%,. Going forward, the focus remains to tap multichannel expansion.

The second point is increasing production facility

In case of diamond jewellery existing capacity of domestic diamond jewellery production of 60,000 pieces is going to double in the next six to eight months.

Likewise for gold jewellery products, the focus has been to expand capacity in Kolkata and Coimbatore factories.

In case of exports, the company plans to enhance the production capacity for overseas market from existing 100,000 pieces per month.

For the working capital efficiency

On an annualized basis the working capital cycle has reduced significantly such that the debtor days has come down from 216 days in the corresponding quarter last year to 167 days this year. Inventory levels have also reduced from 126 days of inventory to 104 days of inventory.

Overall, the working capital has reduced to about 45% from 59% in the corresponding quarter last year.

As far as the development of the global operations are concerned, USA has significant turnaround with market recovery coupled with operational efficiency

As far as the restructuring activity is concerned, Gitanjali has engaged KPMG for advising on the same primarily to unlock shareholders' value and maximizing returns. The final outcome of the same should be announced by April 2011. Thank you. If you have any questions we are ready to answer your questions.

- Moderator:** Thank you Sir. The first question is from the line of Dimple Sheth from SKS Capital; please go ahead.
- Dimple Sheth:** Good afternoon Sir. Congratulations on good numbers. I would like to know whether this growth trend will continue for the next quarter and future ahead.
- Abhishek Gupta:** Value growth will continue for now. The volume growth may not be sustained because the commodity prices have increased, but value growth will remain, we believe that it will be a good 30-35% growth.
- Dimple Sheth:** What do you look at the revenues closing this year?
- Abhishek Gupta:** Total revenues will be in excess of Rs.9000 Crores.
- Dimple Sheth:** Are you expecting to sustain the margins of 6.4%?
- Sunil Varma:** Yes we are.
- Dimple Sheth:** The number of stores you are going to open in the upcoming quarter and FY 2012?
- Abhishek Gupta:** Number of stores we track by square feet and we had 1 million square feet at the end of FY 2010. We have added another 4 lakh square feet till these nine months and we expect 6 lakh square feet by FY 2012, so we should be at 2 million square feet by next fiscal year.
- Dimple Sheth:** Like the retail stores are in tier 1, tier 2 cities or any metropolitans only?
- Abhishek Gupta:** Our own stores are in tier 1, tier 2 cities. Franchisees have penetrated into tier 3, tier 4 towns and we are also expanding more in tier 3, tier 4 towns going forward.
- Moderator:** The next question is from the line of Shyam Bhat from Sunidhi Securities; please go ahead.
- Shyam Bhat:** I just wanted to ask about the real estate project which is coming in Andheri whether this project would be giving any revenues in this particular quarter, in quarter ending FY 2011.
- Abhishek Gupta:** Not the Andheri Project.
- Shyam Bhat:** And the other project?

- Abhishek Gupta:** Borivali, yes, the Borivali project should continue giving revenues for the next four quarters.
- Shyam Bhat:** Andheri Project would not be counted for this particular quarter it would be giving the revenue from the FY 2012 year?
- Abhishek Gupta:** Yes.
- Shyam Bhat:** What is the expectation on the Borivali project revenue and the margin?
- Abhishek Gupta:** We are expecting over Rs. 300 Crores topline and nearly about Rs. 150 Crores profit. We have already sold out nearly 45% of the flats at the Borivali project
- Moderator:** The next question is from the line of Naga Deepika from Capital Markets; please go ahead.
- Naga Deepika:** I just want to get some colour on LVMH Private Equity for minority stake and how is that going to strengthen in coming days?
- P.K. Dutta:** These are all press reports and it is not only in capital but you would have possibly read about others also like Bain and Apex, etc. A lot of people have approached us, and we are actually in the process of talking to them, but nothing has crystallized as yet, so we will keep the market informed if there is something which is substantiated and if anything gets crystallized. Our concentration is on restructuring of the company and looking at the best value for stake holders, we are not sure whether we are going for PE or whether we are going for any other model, so after the restructuring exercise is over we will decide as to what we are going to do.
- Naga Deepika:** I understand you said like the top line would be reaching around 8,500 Crores in the last conference call for FY 2011 and now you have raised it to further 500 Crores and above, what is the actual focus and how are you trying to get these revenues, besides India what markets are you focusing more on?
- Mehul Choksi:** We have both volume and value growth in terms of our projections and if you see the prices of raw materials particularly diamond and gold, both have considerably increased by 20-25% over the last year, so our projections are same as far as volume is concerned. But value wise we have exceeded our expectations in terms of revenues. India remains as the real growth engine at the moment.

- Naga Deepika:** Can you just share with us what were the volumes during the quarter and corresponding previous quarter?
- Mehul Choksi:** As far as gold jewellery is concerned, we have registered a growth of only 15% in volume and value wise it is 45% . In case of diamond jewellery, we have grown by nearly 20% in volumes. In case of diamonds, we have grown by about 15 to 20% in volumes, while the price of diamonds has increased considerably in the last half.
- Naga Deepika:** Is this kind of price growth sustainable? Are the customers still coming and buying? How do you see the buying trends in diamond jewellery particularly?
- Mehul Choksi:** The pattern that we have seen for the last two quarters was that even when gold prices increased so much, people went for more buying because people have been successfully investing in gold, both the commodities, gold and diamond fall in to investment category for now and people believe that the prices will still go up. At the moment the demand is much greater compared to what has been produced or what is being mined, so it looks like this particular trend will carry on for another year or so.
- Naga Deepika:** Can you tell what is the debt on the books for the quarter ended December 2010, consolidated?
- Sunil Varma:** The consolidated net debt in the books is Rs. 2,672 Cr.
- Naga Deepika:** This would include the working capital right?
- Sunil Varma:** This primarily is working capital.
- Naga Deepika:** Can you just give us an update on 2 lakh square feet facility at Hyderabad SEZ and as you said there was some potential of around 600 Crores, what was the situation there on this project?
- Abhishek Gupta:** This is a rental project; for SEZ we are expecting rental revenues to begin from next year onwards.
- Naga Deepika:** Is the work still in progress or is it according to the planned schedule?
- Abhishek Gupta:** We had constructed 5 lakh square feet out of which 1 lakh sq. ft is captively being used and another 2 lakh sq.ft is being rented out from this year onwards.

- Naga Deepika:** And the other 3 lakhs square feet?
- Mehul Choksi:** It will be rented out from next year onwards. It is one of the most successful SEZ so far, it is earning revenue of Rs.1,000 Crores as far as exports are concerned and among the three SEZ existing in gems and jewellery it is one of the fastest growing as of now.
- Naga Deepika:** An update on US and Samuels & Rogers; how are the retail stores doing there, did we open any retail stores in the quarter?
- P.K. Dutta:** No we have not opened any retail stores in the quarter, we are actually doing with the same number of stores as we had in the previous six months. In fact, going forward, we might close one or two stores in the next quarter. But the retail has actually turned around a bit in US. The prognosis for the next three months is again very, very upbeat, the margins have greatly increased which is not only for us but for many of them as well. We are actually hopefully of breaking even in the U.S this year.
- Naga Deepika:** By the end of March 2011, right?
- Mehul Choksi:** That is right. The supply chain profit is what we have been making already. On the retail level itself we will be breaking even there.
- Moderator:** The next question comes from the line of Rishi Maheshwari from Enam Asset Management; please go ahead.
- Rishi Maheshwari:** Congratulations gentlemen, good results, impressive numbers, what I wanted to know was your expansion of margin strategy in diamond, I was pleased to know that the margins have expanded about 150-160 BPS over last year, now how is that fruitful. With the value increase in diamond does that in anyway help you in increasing your margins towards diamond because most of it is actually booked right then and there.
- Mehul Choksi:** No the demand is greater compared to supply for now and looks like it is going to remain so for the next couple of years. There is a greater demand compared to what is produced by the Indian diamond industry as such, so basically there is a greater margin for manufacturers.
- Rishi Maheshwari:** Does the margin at 4% EBIT also look like Sustainable Mr. Choksi?
- Mehul Choksi:** Yes, it looks like that this is going to remain as such.

- Rishi Maheshwari:** Wonderful and can you also give us a sense of what you look as growth in diamond jewellery and within that exports and imports, exports and domestic?
- Mehul Choksi:** Well, in exports we are expanding the market, as you must have known that we have bought a chain, a brand from Italy, and so we are concentrating on exports to different markets too. As far as America is concerned it has stabilized for us. It is not going down anymore, so exports to America stand where they are, unless we expand our stores which we are not intending for the next six months. Apart from that, we are likely to cross another \$20-30 million as far as diamond jewellery is concerned due to our new acquisitions of new brands for the coming year and we are also expanding in the ethnic markets like Sri Lanka, Bangladesh, etc. Japan is also becoming an important market for us as far as exports are concerned. As far as domestic market is concerned there is a tremendous growth due to our great distribution and franchising operations as well as retail penetration. Basically we have seen a significant move from the markets moving from traditional to modern markets over the last one year so the growth has been faster in the last one year.
- Rishi Maheshwari:** So, is there a number that you would like to put, you just mentioned about 30-35% growth is what you are looking at next year and this year would be about a 40% kind of growth, so within this how much is growth is from diamond and how much from jewellery?
- Mehul Choksi:** We feel that we will continue to grow at about 45 to 50% in diamond and about 50% in jewellery.
- Rishi Maheshwari:** So 45 to 50% in diamond and 50% jewellery would mean about 45% at least for the overall company next year?
- Mehul Choksi:** Yes, but this would also be because the value of the commodity has increased.
- Rishi Maheshwari:** But do we take as 45% growth for 2012; is that realistic right now?
- Mehul Choksi:** Yes, we will take it that way.
- Rishi Maheshwari:** Just on the competition side there are couple of large names which are coming out with IPO, TBZ and Joy Alukkas, both are looking aggressively on IPO front, what is your sense, will the cash rich companies now with the IPO money pumping in, you think that can be a potential threat to your chains?

- Mehul Choksi:** Well if you see the entire business in India is nearly 300,000 Crore rupees as far as this category is concerned. This is nothing but a transformation from a traditional outlet to more modern outlet. These chains are more regional than national and they are more a shop brand than a product or a national brand, so I think either they will be part of the new expansion or possibly from a one shop business it will be converted to more shops, we feel that more and more business would go for a modern retail.
- P.K. Dutta:** Rishi, I just want to tell you one thing. This is where we think we are a trend setter in many ways. The organized sector which was largely started by us and Tanishq, is now being joined by these new guys. There will be so much of competition between the players within the organized sector, and the significant value of all these guys including ours will come from converting the unorganized sector to the organized sector.
- Mehul Choksi:** One more thing Rishi is that these companies are mostly retail penetrated, they do not have manufacturing facilities and most of these are our large customers too. The company enjoys much more strength because of its integrated play.
- Moderator:** The next question comes from the line of Sudhir Pandit from Parag Parikh Financial Services; please go ahead.
- Sudhir Pandit:** I just wanted to know the US percentage of revenue, your sales from US?
- Abhishek Gupta:** We did sales of \$130 million for retail. In case of events business we are doing about close to \$70 million, totally \$200 million from US last year.
- Sudhir Pandit:** Would the restructuring involve a spin off strategy since I believe the private equity companies are not interested in the infrastructure and realty side but more in the brand and the retail chain side, so would this involve a spin off?
- P.K. Dutta:** Well, actually you see I think we have answered this question before and as Mr. Choksi had earlier said, it is a very latent stage. We are actually going ahead with the restructuring which we are discussing with KPMG. We will come out with something and only then we will go to the PE guys. So it may be a little early for us to say whether somebody is interested in infrastructure or not. Hopefully we should be able to answer this question in say about eight to ten weeks time.

- Sudhir Pandit:** Recently you had also done a brand evaluation of your brands, for all the brands could you give me the gross estimates of what the valuation was?
- Mehul Choksi:** In the last brand valuation which was in December 2009, we valued only four of our brands which were valued at Rs.1,500 Crores,. Post that we have not undertaken a brand valuation exercise. We are however, planning to do this exercise again for all our brands together. At that time we had primarily four brands but now we have many more brands to be revalued. At that time it had been indicated that there is a growth possibility of around 100% in the value of these brands over the next two years.
- Moderator:** The next question is from the line of Percy Panthaki from HSBC; please go ahead.
- Percy Panthaki:** I have a few questions one is on the Hyderabad SEZ do you have any tenants who have signed and sealed full agreements?
- Mehul C. Choksi:** Yes, we have three to four tenants already.
- Percy Panthaki:** What is the total square feet that they have signed up for?
- Mehul Choksi:** It is about 25, 000 square feet.
- Percy Panthaki:** What is the average rental?
- Mehul Choksi:** Rentals are about 35 to 40 rupees.
- Percy Panthaki:** Do you have visibility on any more tenants coming in?
- Mehul Choksi:** Sure. The SEZ is shaping up well. We are training more and more people on diamond manufacturing as well as jewellery manufacturing, there are no SEZs in the country which have both the facilities and workers for both. The main challenge was of course to train people. Now we have a couple of experts who have come in and who are training the people and more people will be trained will be rolling over to the other factories too.
- Percy Panthaki:** Sir can you give me an idea these people who have signed up as tenants were they originally in this business in Hyderabad or are they relocating from some other place or are they completely new in to this business?

Mehul Choksi: Well, at the moment most of them are from Hyderabad or southern part of India except one gentleman who is from the northern part of India.

Percy Panthaki: Second question Sir is on the diamond segment, earlier we had a strategy to reduce the salience of this within the total and especially given that the return on capital in this segment is lesser than the cost of capital, what is the reason that we still want to do this business?

Mehul Choksi: There is a great demand for diamond this year. The prices of diamonds have probably increased by 50%, it is the highest increase of a commodity even more than gold and that is the reason. If you see our inventories overall have reduced too, so basically it is more a sellout and at the same time there is a great demand for diamonds at the moment. If you see the last year's performance, most of the branded players worldwide have done extremely well, even the watches have done extremely well, so there is a great demand for diamonds in the organized sector too and that is the reason that our sales are more.

Percy Panthaki: I understand that demand is robust but if the business model is such that we are not generating any positive EBA then what is the reason, I understand we cannot close the business because it has synergies, we are a vertically integrated player but what is the reason for actually increasing the sales on this, can we not just maintain at current level?

Mehul Choksi: some of the proportion could be a one time sell out, we could reduce the inventory. In the slowdown there was a build up of inventory last year and probably in this season we have been able to reduce the stocks too, it may not continue, our concentration is very much jewellery, the growth in diamond may slow down because our concentration is on jewellery.

Percy Panthaki: My question was in the context of your earlier conversation on this call where you said that diamond even next year can grow at about 45 to 50%, so just in that context?

Mehul Choksi: Prices have increased and inventories have gone down; if there is a demand we must sell the merchandise.

Percy Panthaki: My next question is on the working capital, we have done a good job in bringing it down, just wanted your views on whether it is possible as a percentage of sales to

bring it down further and secondly what is the possibility or the probability that as a percentage of sales again it could actually increase from these levels in future?

Mehul Choksi: Well, it will remain. We will try and remain at this or probably bring more efficiency. At the moment the demand for both diamond and gold is robust, so we see quite a good chance that we could make it more efficient too, it depends entirely on how the market goes for the next six months.

Abhishek Gupta: Percy, we have brought it down from 62% in FY 2010 to nearly 45% if you analyze the revenues, 45% is the level we want to remain at, if possible may be two years down the line we can bring it down further. But as we see it, it will remain at 45%.

Percy Panthaki: My question was yes obviously whether there is possibility to bring it down, you have said that headroom is very small but I just wanted some comfort on in your estimation what is the quantum of risk that it could actually go up again, is it a very, very small probability?

Mehul Choksi: I do not think there is any chance that it will go up for now. The trend suggests reduction in credit, in the business and we are no exception to this. Hence, we do not think it will go up in the near future.

Percy Panthaki: My last question Sir is on the restructuring, it is not clear what form it will take, but suffice to say if there is going to be a third party investor coming in, he will want that part of the business isolated from the remaining part so that you can have visibility in terms of cash flow and profits, so considering that scenario how do you think the diamond business will fund itself, let us say the investor says that I want the cash flows of the jewellery or the retailing business separate and I do not want that cash flows to go in to the diamond business because then basically it is a question of indirectly diluting my stake in that scenario how do you fund your diamond business given that the diamond business itself does not generate enough money to fund its own growth?

Mehul Choksi: Percy in case of the diamond business, we have the option to reduce the inventory levels and it will be a self generating and self sustaining business going forward.

P.K. Dutta: If we go for any PE, we are looking at it only if it is going to help expand our business or take us to a newer height. If the jewellery business prospers it is going to help the

diamond division itself because the diamonds are going to come from our own factories.

Percy Panthaki: But for the third party portion Sir, I understand that for your internal sales it will help but for the third party portion how will you do that?

P.K. Dutta: I think there is an answer in your question itself Percy. For the third party, if it happens, as a PE comes in and as those structures, as you say, are put in, obviously the third party will reduce, so there will be a natural kind of relaxant in that business and ultimately what we are thinking to achieve for the organization we will achieve it in our way.

Moderator: We have a followup question from the line of Dimple Sheth from SKS Capital; please go ahead.

Dimple Sheth: From now on what is the outlook on gold and diamond prices and in the quantum basis what could be the prices stabilizing at?

Mehul Choksi: This full year we expect gold to be volatile, the gold is not going to go down, possibly it may go up and go down till the US stabilizes and the US interest rates start increasing. As far as diamonds are concerned, there is a shortage from both, mining output as well as manufacturing output. During the recession we have lost about 200,000 workers and as far as mining is concerned it has increased by 20%. But mining has gone down by about 40 to 50% last year and no big mines are coming up in the near future, so it looks that the diamond prices will also remain stronger except that Zimbabwe merchandise may come in but in limited quantity.

Dimple Sheth: Sir I just missed on your debt figures; can you just give me your debt figures?

Sunil Varma: The consolidated net debt is at Rs. 2,672 Crores

Moderator: The next question is a followup question from the line of Sudhir Pandit from Parag Parikh Financial Services; please go ahead.

Sudhir Pandit: Sir my question is on the FCCB; could you tell me at what price it converts and when is the conversion date?

Abhishek Gupta: It converts at 220 and the date is end of the year; November 25, 2011.

- Sudhir Pandit:** The price would be?
- Mehul Choksi:** 220 rupees.
- Moderator:** As there are no further questions I would like to hand the floor back to the management for closing comments.
- Abhishek Gupta:** Thank you everyone. Thank you for your time and please feel free to get back if you have any further questions offline. I really appreciate your participation and from the management of Gitanjali we thank you for joining this conference call.
- Moderator:** Thank you. On behalf of Gitanjali Gems Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.