"Gitanjali Gems Q4 FY11 Earnings Conference Call"

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MODERATORS: **MR. MEHUL CHOKSI**
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MR. DUTTA
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Moderator: Ladies and gentlemen good day and welcome to the Q4 and FY'11 results conference call of Gitanjali Gems. As a reminder for the duration of this conference, all participants' 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. If you should 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 from Gitanjali Gems. Thank you and over to you Sir.

Sunil Varma: Welcome to the FY'11 annual release of financial results of Gitanjali Gems Ltd. This year we have crossed many milestones in terms of revenue and profitability. The year has also been significant for our Indian business. To take you through the financials of the company for the financial year 2011, consolidated revenue for the year reached Rs.9,456 Crores, a jump of 44.9% compared to the last year. EBITDA for the year was Rs. 648 Crores with a growth of 46.8%, while profit after tax reached Rs. 355 Crores with a growth of 77%. For the year, we achieved an EPS of 41.8, a growth of 76% over the previous year. We have increased our EBITDA margin from 6.7% to 6.9%, while the PAT margin has increased from 3.1% to 3.8% as compared to the last year. To highlight the key developments in FY'11, our mainstream brand Nakshatra, Asmi, Gilli, D'Damas, and Sangini continued their journey of transformation to retail chains. These brands penetrated into the hinterlands of the country primarily through the own stores and franchisee route. We have developed about 20 different retail formats to expand these brands in the form of Exclusive Brand Outlets and Multi Brand Outlets. Besides this, the year also achieved significant development of complementary brands and categories under Parineeta, Diya, Maya, and Rivaaz brands. Multi branded stores under the umbrella of Gitanjali Jewels, Maya departmental Stores, Gitanjali Lifestyle, Giantti and Shuddhi have established themselves as retail chains. In FY'11, the company added nearly 300,000 sq feet of retail space, primarily through company-owned stores and franchisee route classified under EBOs and MBOs. We have reached over 3300 points of sale with about 300 additions in FY'11. We will continue expansion in these formats to expand the existing 1 million sq feet of retail business to about 2 million sq feet in the next three years. For our international business, we are pleased to announce profitability for our Samuels and Rogers stores in the US. We have significantly improved our EBITDA margins at the store level for FY'11. Also we have achieved a synergy by in-house supply from our manufacturing facilities in India. The other significant acquisition completed this year was the bouquet of Italian Brand - Valente, and the DIT Group's Brands - Stefan Hafner, Nouvelle Bague, IOSI and Porrati. One of the sources "JCK" has also featured these brands amongst the top 10 global jewellery designer brands. Our strategy is to penetrate target markets of Europe, Middle East, Japan, and Russia and put ourselves at par with luxury brands of the world. According to a recent survey by McKinsey and De Beers, China and India will together account for over 50% of incremental demand for growth in the world diamond market over the next five years. China is our next market that attracts us, both from the size and the growth perspective. In the coming year, we are looking forward to expand possibly with a combination of manufacturing and retail operations in that territory. In FY'11, we also achieved significant gold jewellery sales as a complementary category to our diamond jewellery. We are launching gold jewellery collections under various brands as well. In the last financial year, we have also initiated building up additional production facility to increase our capacity of 5000 pieces of finished jewellery per day to about 8000 pieces per day. The factory is scheduled to start in the current year to support our jewellery business expansion in India and overseas. It fits into our DNA of being the world's largest integrated jeweller with sourcing edge of rough diamonds, having competencies in cutting and polishing, jewellery manufacturing, branding, and retailing in India and overseas. We have the ambition to become the world's largest branded jeweller and retailer. On the Infratech side, the Borivali project in Mumbai is on track for completion in 2013. We are expecting an income of Rs. 350 Crores as revenues in the next two years. Besides there are unlocking opportunities from other projects in Andheri. Further, the year has also been significant in terms of business restructuring we initiated with KPMG as our advisor. We have been advised to look upon our business in different verticals depending of their nature and activities. We have also appointed Brand Finance UK Ltd. to value our mainstream brands. By the next two months, we will complete both these exercises and take necessary steps to enhance and unlock shareholders' value. To conclude, overall jewellery sales worldwide have done well compared to the other retail categories and luxury segments. Particularly, branded jewellery will outshine in coming years. We will continue focusing on India and China, bringing Italian designs to dominate the western world as well as expanding gold jewellery to complement our diamond jewellery category. Growth in manufacturing and retailing will drive the momentum for the future.

Moderator: Thank you. The first question is from Forum Parmar from Sarthi WM. Please go ahead.

Forum Parmar: Congratulations to you Sir, for the good set of numbers. My question is can you just brief us about the guidelines for FY'12?

Mehul Choksi: The growth is going on. We have increased our manufacturing facilities as well as our retail penetration is going on because still in India it is an interesting environment. We have started gold jewellery and we have got a very, very good response. We feel that this year the numbers could come faster. EBITDA may not increase because of gold jewellery, the total EBITDA will increase but not the percentage wise, but overall growth could be probably faster than even last year as far as sales are concerned.

Forum Parmar: Sir, can you just give me from the numbers point of view?

Mehul Choksi: We have had a historical growth of 35% for the last couple of years. So we feel that we will be able to continue the same or higher growth as far as sales are concerned.

Forum Parmar: Okay and now what are your plans Sir regarding expanding production capacity?

Abhishek Gupta: We have plans to increase our production capacity from 5300 pieces per day to nearly 8000 pieces per day, and this will happen in FY'12 and this is required further for the jewellery in India as well as overseas.

Forum Parmar: Okay and Sir what about their exports, how do you see your exports growing?

Mehul Choksi: This year we have seen a significant growth as far as American market is concerned. We have seen about 6% to 7% growth and probably going up to 10% growth as far as the American market is concerned. We will have some numbers from Europe too, as we have acquired these brands and we will have some exports from India as far as that is concerned. So our international scenario is certainly positive and not negative, but we do not expect more than 10% growth as far as international business is concerned.

Moderator: Thank you. The next question is from Abhishek Ranganathan from MF Global. Please go ahead.

A. Ranganathan: Just from perspective of strategy, trying to understand predominantly you are focused on diamond jewellery and studded jewellery. You have said you will be entering the gold jewellery. I just wanted to understand how each of these markets are growing and how do you see them go on for the next few years?

Mehul Choksi: Last year, the overall growth in the jewellery business in India has been nearly 40%; the gold jewellery consists of about 80% of the total sales. The market in the last three years has nearly doubled, of course due to the commodity price increase also. The significant price rise has happened from last November till now. Of course, we will see increased number as far as value is concerned, but overall volume also is very attractive in this category. In the last quarter, despite such a strong price rise, particularly for the last four months, volume has grown by 10% to 15%. Normally we would expect a stagnant market as far as volumes are concerned, but both diamond and gold jewellery have shown a great advancement in the last four to five months and we expect the same to continue. The prices of diamond and gold have increased in the last three to four months by more than 20%.

A. Ranganathan: Is this the good trend, which we are going to see irrespective of the volatility in prices we will see this? We have seen prices rise in one direction, but I just want to be a little counterintuitive if the prices were to move in the other direction, how do you actually see the demand because you have been in the business for a much longer time and you have seen cycles?

Mehul Choksi: As far as gold jewellery is concerned, irrespective of prices going up or down, for some reason it still attracts the consumer. We have seen a decline in the past also and we have seen that the demand picks up around that time too. But this time in particular I think that over the last couple of years, people have built up really good confidence in the jewellery category, as such people have seen this as alternative investment compared to many other investments, so probably the craze is more. Apart from India, the overall world is waking up; particularly American sales have started going up. We will be conservative to say exactly what happens over the next six months in the American market as such, but overall worldwide demand has started going up except Europe is still less.

A. Ranganathan: Sir, how much volume growth have we seen, if we want a breakdown of jewellery in the volume and value?

Mehul Choksi: It is 15% as far as volumes are concerned. At Gitanjali, we may have grown more because we have also the width other than only for store increase.

A. Ranganathan: Basically you are saying those too are additions.

Mehul Choksi: Yes, correct.

Moderator: Thank you. The next question is from Alex Shevelev from 8 Investment. Please go ahead.

Alex Shevelev: Thank you for taking my question. Could you elaborate on the margin, specifically in jewellery division, and how you see that doing next year? Do you expect the margin to be flat on a percentage basis?

Abhishek Gupta: Alex, in jewellery we have achieved an average margin of 9.5% to 10%, and going forward as the gold sales rise, as a percentage of total sales, we expect the jewellery margin to remain slightly at the same numbers, but overall EBITDA will increase. In absolute terms, the EBITDA will certainly increase and you know it will multiply much faster, but the EBITDA margin as a percentage of sales will more or less remain the same.

Alex Shevelev: Okay, and on the Samuels business as well, what would you say would be sustainable in a customers context that a margin that you could target in the near term for that business?

Abhishek Gupta: At Samuels, we are expecting a profit margin level of about 10% on a sustainable basis, and we are targeting FY'13 onwards to achieve that. We are talking about EBITDA margin.

Alex Shevelev: Yes, that 10% you said was the PAT margin?

Abhishek Gupta: The EBITDA Margins

Alex Shevelev: Also, the process that you are currently running with KPMG, I am hoping you could may be elaborate on some of the parties that are currently may be attached to that process.

Abhishek Gupta: With KPMG we are running a business restructuring process and this will give us flexibility to make our financials in manufacturing, in retailing, in branded jewellery, and international business in a way that is easily available. So this entire business restructuring activity will give us different buckets of business as per their workings, and at the end of this report we will come out with an announcement of what would be the revised structure of the business and how the reporting would happen, and this will benefit in terms of numbers of balance sheet, and profit and loss, by different divisions and segments.

Alex Shevelev: May be you released your intention to issue 250 million convertible, do you have any parties that you potentially have lined up for that already?

PK Dutta: We are actually looking into it as a matter of fact, but as I speak to you now, we do not have really parties lined up for this at this particular moment, but yes, very soon maybe within the next two to three weeks we should be able to come out and inform the market about it.

Moderator: Thank you. The next question is from Naga Deepika from Capital Market. Please go ahead.

Naga Deepika: Congrats on the good set of numbers. Three points, first to confirm on what is the net profit we got from Samuels Jewelers for FY'11?

PK Dutta: Are you talking about the net profit?

Naga Deepika: The PAT margins.

PK Dutta: I am talking about the EBITDA, we got a positive EBITDA of 14 Crores.

Naga Deepika: Okay and it is turnaround?

PK Dutta: It is turnaround because last year we had a negative EBITDA of -32 Crores and this year we have positive EBITDA of 14 Crores.

Naga Deepika: Okay. I was talking about the bottom line, at PAT level did it report any profit? How many stores are there, particularly in Samuels Jewellery, and do you want to increase any stores in US?

Mehul Choksi: Basically we are looking at the performance. We have 115 stores for now and we are seeing the performance, at the moment for the next six months we will not be adding anything. We want to see America as a consistently growing market before we take any further step, but you must understand that we have gone on the EBITDA plus this year. Supply-chain profit is always very high in India, so it is a wonderful model for us.

Naga Deepika: Okay, getting in to the gold jewellery business I think the gold jewellery business will have higher margins than the diamond jewellery, is it so?

Mehul Choksi: There is a big change. In the gold jewellery, the volumes are much bigger, but the margins are much less compared to the diamond jewellery business.

Naga Deepika: What would be the margin level now; we could see around 9% for the diamond?

Mehul Choksi: This is a diamond and gold mix, this year we have achieved 40% gold and 60% diamond, and we expect that gold jewellery will also grow further for the coming year.

Naga Deepika: In the presentation remarks, you said that there were some capacity expansions from 5300 pieces to 8800 pieces. So where is this manufacturing facility coming?

Mehul Choksi: This is in Bombay and Hyderabad. These are the two facilities that we are increasing, and we have capacity. In fact, we are adding two more factories in Mumbai.

Naga Deepika: Okay. When this will be expected to commence?

Mehul Choksi: In the next three months, both the factories will commence. One is going to start in June and one is going to start in July.

Naga Deepika: The Bombay in June and Hyderabad in July?

Mehul Choksi: No. In Bombay there are two more factories, one in June and one in July. In Hyderabad, we are just adding the capacity, and then we are making one more unit, which is for domestic market.

Naga Deepika: Okay, can you please give the update on the Hyderabad SEZ, when will the 400,000 sq feet be completed?

Mehul Choksi: We have completed already. Half a million sq feet of construction is already finished and out of which 1,50,000 sq feet is already occupied.

Naga Deepika: How much will be the cash flowing into the P&L?

Abhishek Gupta: Cash flow will start to come from this year onwards, at the moment captively consumed 1, 50,000 sq feet and we are signing out agreements to lend out to third parties. From this year onwards, the cash flow will start. We are expecting a cash flow of about 13 to 14 Crores from next year onwards.

Naga Deepika: Okay, how about the Andheri project? Did we start booking any sales there?

Abhishek Gupta: No, the Andheri one is scheduled to start from July onwards. We have not started booking, as we have not started the project yet there. The factory is about to finish. We will commence production from June and July.

Naga Deepika: Sir, my last question will be on the volumes of gold and diamond jewellery, while the prices of gold and diamonds are in a higher trend, what kind of sense you get from the market on demand front. What are the key drivers of demands for gold and diamond jewellery inspite of higher prices, both in domestic as well as international markets?

Mehul Choksi: Basically, besides emotions in India both jewellery sell mostly for wedding, which is a kind of necessity so the markets are growing, and also it is serving as an investment tool to India, and basically people are investing more in this category.

Abhishek Gupta : Deepika just to add on to that you know last year India has imported nearly 960 tonnes of gold, which is a record in terms of volumes for the year and these prices fairly indicate that volumes are much in demand as compared to the price rise

Naga Deepika: Your restructuring the business is still under progress?

Mehul Choksi: Absolutely. We are expecting this to finish in a month to month and a half.

Naga Deepika: Because in the last con-call we also had the same point that it is still in progress.

Moderator: Thank you. The next question is from Karan Gandhi, an individual investor. Please go ahead.

Karan Gandhi: Just wanted to understand your approach towards moving towards more of diamond jewellery business or more of gold jewellery business?

Mehul Choksi: The growth in the diamond jewellery we expect to continue at 30% to 35%. We expect growth in gold jewellery to accelerate by above 50% for the coming year.

Karan Gandhi: If I really have to ask a very fundamental question, what is driving such high growth rates in the jewellery segment?

Mehul Choksi: There is a commodity price increase and actual demand increase. There is a 10% to 15% additional demand increase in volumes and about 25% to 30% price has increased over last year.

Karan Gandhi: Okay, would you say that this 10% to 15% volume growth is driven by panic purchases of gold or would you see it sustaining in the future going ahead?

Mehul Choksi: If the price stabilizes, we expect more demand to come up as far as volumes are concerned. To answer your question, I do not think in our view, there is no panic purchase as a matter of fact. Yes, there could be some kind of an investment in gold to hedge against inflation, etc. but you see we are talking only about gold jewellery. So it is largely because of the demand factor and as you would know in India the purchasing power parity is increasing quite a bit.

So in the near future, at least in the next two or three years, we find that we should be growing at least about 15% to 20%, and for that matter any established business would grow by that percentage.

Karan Gandhi: Just to understand on the margin front, what kind of margins would be for the diamond jewellery versus gold jewellery?

Abhishek Gupta: In diamond jewellery we are nearly about 15% at the EBITDA level and in gold jewellery we are nearly 5% at the EBITDA level.

Karan Gandhi: Okay, and do you see any improvement in gold jewellery margins?

Abhishek Gupta: We can see, but the more we move downstream in selling gold jewellery in our own stores under the brands Shuddhi and Maya, we will see an improvement in margins there. At the moment we are selling it to the distribution channels, so these brands are being sold mostly in the southern market but through distribution channel, but the more it translates to our own stores we will see improvement in margins. And our own stores are increasing at the moment.

Karan Gandhi: I have to understand what kind of steady state margins would be under the own store level for gold jewellery business?

Abhishek Gupta: At the own store, we should have EBITDA level of nearly 12% in the gold jewellery as well.

Karan Gandhi: 12% and that is a sustainable margin?

Abhishek Gupta: That is a sustainable margin for both the brands that we have - Maya and Shuddhi.

Karan Gandhi: Coming to the working capital cycle, if you could briefly explain the working capital requirement for diamond jewellery as well as gold jewellery?

Abhishek Gupta: For diamond jewellery we require nearly three months of inventory and we require nearly one month of receivable, all channels put together. For gold jewellery we have nearly one month of inventory and about half a month of receivables. So nearly one to one-and-a-half months of working capital cycle is there. The manufacturing cycle for diamond jewellery is about one-and-a-half months and for gold jewellery is about one month.

Karan Gandhi: Also you have a gold loan running at your end, if you could give some highlights on that, how does that help you in the diamond as well as gold jewellery business?

Mehul Choksi: It is a hedging tool basically. Instead of borrowing rupees, we will borrow in a gold loan as such, particularly for gold jewellery business, but for diamond jewellery business normal it is paid up, and it is like a finished product once it is manufactured. As far as gold jewellery is concerned, always we sell the gold jewellery against the gold loan, so it is a good hedging product so we are not really fixed with the prices at the retail level. If your question is to how we hedge our gold risk, in fact we do not take a risk on gold at all. We borrow gold and only when the gold is sold we actually book the purchases, so whatever be the reigning price of gold at any point of time we purchase the gold at that particular price.

Karan Gandhi: Likewise, the sales also at the front end are marked on a day-to-day basis?

Abhishek Gupta: Absolutely.

Moderator: Thank you. The next question is from Alex Shevelev from 8 Investment. Please go ahead.

Alex Shevelev: On the Samuels business for a second, what was the revenue in the year that had just gone?

Abhishek Gupta: In terms of revenue it was 600 Crores.

Alex Shevelev: So it is fair to say putting that with the 10% margin that you are targeting then 60 Crores should be the target in FY13 and going on?

Abhishek Gupta: That is right.

Alex Shevelev: I hope, you can talk a bit about the diamond business as well and specifically where you see margins growing in that business as well?

Abhishek Gupta: In the diamond part of the business, over the last two years if you see we have improved margins at the EBITDA levels and we have now stabilized at 4.5%. We see the same percentage to continue going forward as well, so in the next two years we see that at EBITDA level it should be between 4% and 5%. Only thing is that our sales in jewellery will keep on increasing compared to diamonds as such.

Alex Shevelev: In terms of revenue for the diamond business?

Abhishek Gupta: In terms of revenue, this year was exceptional because of the price rise in diamonds and we see that going forward the jewellery should grow nearly 50% compared to diamond, which should be at 20% to 25% levels.

Alex Shevelev: Just on the convertibles that we were talking about earlier, what price would you consider doing such an instrument at, in the current environment?

PK Dutta: The pricing of course would be subject to the timing and of course there would be SEBI guidelines on that. So there will be a SEBI floor price, so it is all a coefficient of timing. If I had done it today, possibly it would be the floor price plus 10% to 15% premium.

Alex Shevelev: That is above current market price in any case.

PK Dutta: That is right.

Alex Shevelev: Just going into the margin that would have been on the jewellery side, when you say the shift to go with 10% to 15% growth versus 30% to 35% that would, one would imagine, put a downward pressure on your margin. When you are talking about the margins we discussed before for jewellery, roughly the same as they were last year, are you including that effect as well as the Samuels effect?

Abhishek Gupta: It is a combination of Samuels, but besides, in the diamond jewellery we have been experiencing improvement in margin as a percentage of sales, so gold jewellery increase plus the percentage margin of diamond jewellery increase will compensate for that, and overall the EBITDA will remain at the same levels. There will be improvement in diamond jewellery EBITDA margin and an increase in gold jewellery sales. So over all EBITDA will remain more or less similar. Of course, you are pointing it right as far as Samuels is concerned, the improvement in Samuels will also add to the margins at overall margins for the organisation. Samuels is completely diamond jewellery sales.

Alex Shevelev: Sure, but if we were to think, excluding Samuels that the margin should stay similar or is it including Samuels you think the margin should stay similar?

Mehul Choksi: Excluding Samuels also we see the margins improving, as our sales grow the margins improve at the brand level.

Moderator: Thank you. The next question is from Sareena Dayaram from ET Now. Please go ahead.

Sareena Dayaram: I just wanted to understand you are adding capacity and also enhancing your capacity, expanding in Hyderabad and Mumbai. How are you financing these expansions?

Mehul Choksi: Basically, it is a working capital requirement and we have sufficient. If you see, our efficiency has really improved, compared to '09-'10 when the markets were slow. Compared to that, we have accumulated a lot more efficiency. We have much lesser working capital requirement and the cycle has reduced. So from that and from the working capital requirement we will grow with further expand.

Sareena Dayaram: So what is the total investment out there?

Mehul Choksi: The investment is about Rs. 25 to Rs. 30 Crores and it is from internal accruals.

Sareena Dayaram: Okay and do you guys have any other fund raising plans in the anvil perhaps a stake sale or anything of that sort?

PK Dutta: Yes, we have definitely fund raising plans as a matter of fact; because that is one reason why we were doing the restructuring. As you know, we have been in touch with few of the PE investors right at the moment, as I talk to you, one of them very, very active at the moment. So there would be definitely fund raising plans because we want to balance up the equity with the debt for expansion.

Sareena Dayaram: How much are you looking to raise?

PK Dutta: It is very difficult to say, it depends on what kind of growth, but I can tell you with the near term it should be something about $150 million or $200 million.

Sareena Dayaram: I just want to understand about LVMH, are you by any chance in talks with them?

PK Dutta: Yes, we are as a matter of fact, and we are talking on subjects like valuation, etc., so we are in talks with them.

Moderator: Thank you. The next question is a followup question from Abhishek Ranganathan from MF Global. Please go ahead.

A. Ranganathan: Sir, to touch upon the number you said that likely to grow at 50% in jewellery division, if I were to actually just dig a little deeper into this, if we want to look at it from a perspective that how much you are accounting for volume and within volume again how much would you be attributing to new stores and same stores.

Mehul Choksi: We are expecting that if the gold and diamond prices remain at this level, which is likely, the real growth will be 20% as far as the volumes are concerned, and we are growing at 20% to 25% as far as the retail level is concerned, our growth and the weight is concerned.

A. Ranganathan: Okay, so basically you are saying we will be adding 20% to 25% in the stores in the new areas?

Mehul Choksi: That is correct. You must note that we are now launching all of our branches as a complete jeweller shop and each of them has gained about 15 to 20 to 25 stores minimum, going up to nearly 100 stores by some of the MBOs so all of these are growing and that is why we are going to have a width with our own stores as well as franchise stores.

A. Ranganathan: You are looking at retailing at multi brand jewel stores?

Mehul Choksi: Multi brand stores as well as single brands, primarily our diamond brands, but now we are launching as a complete jeweler in the market place.

A. Ranganathan: Same branch will be extended?

Mehul Choksi: That is correct.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the floor back to Gitanjali Management for closing comments.

Abhishek Gupta: Thank you everyone. Thank you for participating in today's call and we look forward to having another call in the next quarter. Thank you all, have a nice day.

Moderator: Thank you. On behalf of Gitanjali Gems, that concludes this conference call. Thank you for joining us.