LSE Securities

Gitanjali Gems - Buy

- Gitanjali Gems is one of the largest integrated diamond and jewellery manufacturers and retailers in India.
- The company will be investing about Rs 400 crore in next one year for expanding its retail business in India and overseas markets.
- The company has been on a buying spree in past couple of months to derive growth. In the recent past, it has bought stakes in Morellato India, Salasar Retail, Spectrum Jewellery and Alliance Jewelleries.
- The company will be increasing its retail outlets to around 500 from the present more than 150 and will also double its overseas outlets.
- The company plans to divest 25 per cent of its holding in each of its brands from September this year, to 'unlock consumers' acceptability level'.

Business Overview

Gitanjali Gems is one of the largest integrated diamond and jewellery manufacturers and retailers in India. The company has operational presence starting from sourcing of rough diamond, cutting, polishing and distributing, to jewellery manufacturing, which includes designing, mould making, wading, casting, sprue grinding, filing, polishing and setting. The company was first to offer diamond studded jewellery at reasonable prices. It uses CAD and CAM processes and latest equipments for creating designs for jewellery.

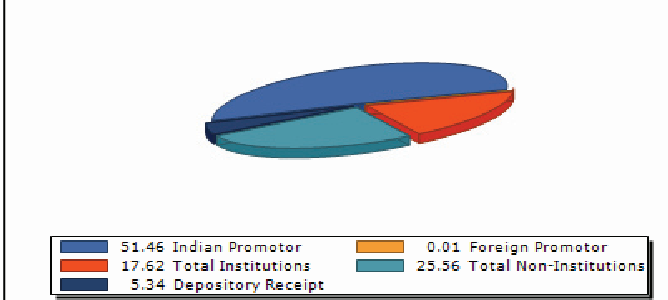
Diamond Business - It is one of the world's leaders in the diamond and diamond-studded jewellery business. The company principally sources its diamonds through DTC. It also runs a centralized operation to sort diamonds for various operations at Antwerp, Belgium - the world's diamond capital. Processing of diamonds is conducted at the company's units at Surat and Borivli in India, Bangkok in Thailand, and Qingdao in China. Recently, its unit at Hyderabad SEZ also went on stream.

The company markets the major portion of its processed diamonds in loose form to merchant jewellers and jewellery houses worldwide. In the form of diamond-studded jewellery, it sells wholesale to marketers of branded jewellery. It also has brands of its own that are marketed only in B2B mode.

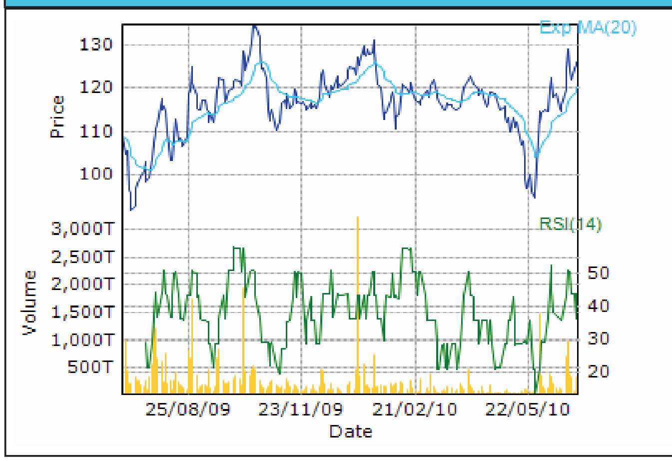
Jewellery Business- Gitanjali produces a diverse range of jewellery - gold, silver, platinum and stainless steel, studded with diamond and other gems - natural and synthetic. Types of jewellery produced by the company include Classic, Indian Traditional, Contemporary, Ethnic and Casual designs, under multiple brands and collections, and targeted at specific consumer and price segments. The company sells a large part of its output of jewellery on a wholesale basis to merchant jewellers under its own store brands and to retail chains. These

Stock Data	02/07/2010
Current Mkt Price (Rs)	126.60
52 Week High	138.00
52 Week Low	86.55
Mkt Cap (Rs. in Million)	10668.58
Return in last one Month (%)	10.57

Share Holding



Performance in last one year



Y-o-Y Performance

(Rs. in Million)

Particulars	Mar 2009	Mar 2008	Change(%)
Net Sales	26938.47	26543.29	1.49
Other Income	2.17	33.94	-93.61
Total Expenditure	25030.24	24789.16	0.97
Operating Profit	1910.40	1788.07	6.84
Interest	559.84	267.07	109.62
Profits After Tax	1267.69	1381.55	-8.24
Reserve & Surplus	0.02	0.02	6.41
Reported EPS(Rs)	14.90	16.24	-8.24
Core EBITDA Margin (%)	7.08	6.61	7.19

include all classes and types of jewellery.

Retailing - The company is also engaged in retailing its diamonds and jewellery. Currently the company markets over 40 brands that are owned and franchised under its retail chain Gitanjali Lifestyle. It has around 150 stores across India and about 140 outlets in US, China and Middle-East.

Financial Health

Gitanjali Gems had reported a net profit of Rs 142.09 crore for the year ended March 31, 2010, up 12.08% over Rs 126.77 crore for the year ended March 31, 2009. Its revenues during the same period rose by 24.54% to Rs 3,354.97 crore from Rs 2,693.85 crore. Both jewellery and diamond segments recorded robust growth in 2009-10 fiscal. The jewellery segment registered 35% growth in revenue while the diamond segment saw 21% jump in revenue over 2008-09 fiscal.

Its earnings before interest, tax, depreciation and amortisation (EBITDA) jumped to Rs 254.41 crore in FY10 from Rs 180.40 crore for FY09, registering a growth of 41.03%. The company's operating profit margin in 2009-10 fiscal improved by 88 basis points (bps) to 7.58% compared to the previous fiscal.

Latest Developments

- Its retail arm -- Gitanjali Lifestyle -- is planning to open 100 watch stores in the next three years. Out of that, 90 stores will be on franchisee basis, while the remaining 10 stores will be owned by the company at an investment of Rs 2 crore each.
- In the beginning of the 2010, Gitanjali Gems acquired the balance 50% stake in the Indian joint venture (JV) company 'Morellato India'. The company continues to hold on exclusive basis, the rights of marketing, promotion, sale and distribution of products of the erstwhile JV partner under the brand names e.g. Morellto, Sector (non-Swiss made collection), Roberto Cavalli, Just Cavalli and Miss Sixty etc.

Industry Scenario

Gems and jewellery form an integral part of Indian tradition. India is the largest consumer of gold jewellery in the world accounting for about 20% of world consumption. The Indian Gems & Jewellery industry is highly fragmented with a large number of domestic private sector companies. A large portion of the market is in the unorganized sector.

In order to give a boost to exports of gems and jewellery, Government took major policy initiatives during 2004-05, like lowering import duty on platinum from Rs.550 per 10 gms to Rs.200. Exempting rough coloured precious gems stones from customs duty at the first stage itself instead of claiming reimbursements later. Rough semi precious stones are already exempt aimed to further

Q-o-Q Performance

(Rs. in Million)

Particulars	Mar 2010	Mar 2009	Change(%)
Net Sales	7916.18	7039.76	12.45
Expenditure	7262.28	6588.35	10.23
Other Income	0.31	0.90	-65.56
EBITDA	654.21	452.31	44.64
Interest	277.07	147.39	87.98
Net Profit	353.04	311.30	13.41
EBITDA Margin (%)	0.08	0.06	28.62
NPM (%)	0.04	0.04	0.85
EPS	0.00	0.00	0.00

Profit & Loss

(Rs. in Million)

Particulars	Mar 2009	Mar 2008	Change(%)
Net Sales	26938.47	26543.29	1.49
Total Income	26940.64	26577.23	1.37
Total Expenditure	25030.24	24789.16	0.97
Operating Profit	1910.40	1788.07	6.84
Profits After Tax	1267.69	1381.55	-8.24

Balance Sheet

(Rs. in Million)

Particulars	Mar 2009	Mar 2008	Change(%)
Share Capital	850.63	850.63	0.00
Reserve & Surplus	18065.56	16977.01	6.41
Total Liabilities	31986.29	28572.90	11.95
Investments	8385.18	5954.36	40.82
Current Liabilities	7719.97	8465.80	-8.81
Net Current Assets	23110.34	22167.30	4.25
Total Assests	31986.29	28572.90	11.95

Key Ratios

Particulars	Mar 2009	Mar 2008
Reported EPS (Rs)	14.90	16.24
Core EBITDA Margin (%)	7.08	6.61
EBIT Margin (%)	6.93	6.61
ROA (%)	4.19	5.82
ROE (%)	6.90	10.87
ROCE (%)	6.17	7.39
Price/Book (x)	0.20	1.06
Net Sales Growth (%)	1.49	19.60
EBIT Growth (%)	6.46	39.88
PAT Growth (%)	-8.24	68.69
Total Debt/Mcap (%)	3.31	0.55

increase the exports of studded jewellery and platinum jewellery.

The gems and jewellery industry continues to face the heat of global economic slowdown. The largely export oriented sector has been hit hard by decline in demand from key export destinations like the US and Europe. Despite some revival in India's broader economy, gem and jewellery have not witnessed any change in fate so far and the declining trend in exports continued in the fiscal 2010 as well.

The sector has also seen huge lay-offs as the declining demand forced producers to cut cost by reducing the number of employees. According to industry estimates, through the second half of fiscal 2009, the industry laid-of about five lakh workers. However, some relief in the regard came in last couple of months and the pace of job losses in the industry is seen coming down. A survey by the labour and employment ministry reported that in fact the net hiring has been positive during the first quarter of 2010.

The positive signal for the industry is that the pace of decline in exports has come down over time and may taper off in next couple of months. The industry body Gems and Jewellery Exports Promotion Council of India believes that the decline in exports will continue till May this year, but may start to recover after that.

The industry has been supported by better exchange rate prevalent in last one year or so compared with the previous 12 months, which has helped cover some of the losses. Nevertheless, the industry will continue to face acute pressure on margins in near term and outlook of the industry for next couple of quarters remains negative.

Investment Rationale

Gitanjali Gems has established presence in diamond and jewellery segment. It has over two decades of experience in diamonds and studded jewellery.

The company has been on the buying spree. In trailing twelve months time period, it has acquired as well as raised stakes in various companies. In July 2009, it acquired 51% stake in Diamlink Inc, a New York-based corporation. This was followed by acquisition of 100% stake in Alliance Jewelleries and additional stake in Spectrum Jewellery, earlier a 50:50 joint venture between Gitanjali Gems and Sanghavi Exports, both in the month of October, 2009. It bought 76% stake in Salasar Retail in December 2009 and balance 50% stake in Morellato India, a joint venture between the company and Morellato & Sector Group of Italy, in January 2010. The timing of all these acquisitions was very important as most of them were sealed when the global economy was reeling under recessionary pressure and valuations were way below their historic averages.

Though the net debt to equity ratio of the company has increased due to the different acquisitions but the company's strategy to grow via inorganic route is likely to show strong revenue and profit growth in the coming quarters.

The company has shifted its focus on branded jewellery retail. Around 60% of the organized mall spaces in the country within jewellery category belong to the Gitanjali Group. It has chalked out mega retail expansion plan for next 3 years. With its expansions the company is all set to witness an impressive improvement in valuation multiples going forward.

	As on March 31, 2010	Projection for 2012-13	CAGR over 3 years
Exclusive Distributors	230	400	20%
Outlets (SIS + Retailers)	2,000	4,000	26%
Exclusive Stores	185	300	18%
Franchisee Stores	215	500	32%

SIS- shop-in-shops, CAGR- compounded annual growth rate

The domestic market size for jewellery segment is estimated at around $22 billion with gold jewellery accounting for nearly 80% of total. The company recorded 38.3% revenue growth in India during FY10 on the back of whopping 61.3% rise in jewellery sales compared to the last fiscal.

The company plans to divest 25 per cent of its holding in each of its brands from September this year, to 'unlock consumers' acceptability level'. The UK-based Brand Finance, in October 2009, valued the four leading brands of the company, Nakshatra at Rs 514 crore, Gili Rs 468 crore , D'Damas Rs 309 crore and Asmi at Rs 210 crore, respectively. Each of its brands is already formally a separate entity, each a registered company. If the plan formalises in the coming days it will help the company in expansion and reducing its debt.

At the current market price of Rs 126.60, Gitanjali Gems trades at a price-to-earning (PE) ratio of 7.51x nearly half compared to its closest peer Rajesh Exports which trades at a PE of 12.67x. The latest EPS and dividend yield of the company stood at 16.86 rupees and 1.48%, respectively against 6.85 rupees and 0.69% for Rajesh Exports. This indicates that the counter is trading at cheap valuation even after strong earnings visibility over the next few quarters. One can buy the stock at current levels with a price target of Rs 145 with short to medium term outlook, keeping in view that rating agency Fitch has improved its outlook for the sector and the company is regularly making efforts to boost its market position.

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