VISIT NOTE

PC JEWELLER

Ambitious growth plans

India Equity Research| Retail

We recently interacted with Mr. Balram Garg, MD, PC Jeweller (PCJ), along with the company's store managers and other senior management. The company expects sales to jump 25% YoY in FY15E and is aiming to triple sales by 2019 and opening at least 20 stores per year (current 45) over the next 3 years (40% each will be in tier 1 and 2 cities and balance 20% in metros). The company is also exploring new growth drivers like online sales, franchisee, gifting options and continues to focus on studded jewellery. 'NOT RATED'.

Robust store expansion; studded jewellery share to increase

By FY17, PCJ will expand to 100 stores (using internal accruals). It also expects studded jewellery share to increase from 29% to 35% which will boost margin. Expansion will be largely through internal accruals. PCJ is reworking on a modified version of the *Jewels for Less* scheme, which is likely to be introduced in Q3FY15 (contributed only ~3% to sales as PCJ was a late entrant in this segment).

Exploring new avenues: On line sales, franchise, gifting

PCJ is planning to tie up with on line retailers like Flipkart, Amazon and Snapdeal to sell its products on line with higher focus on INR5,000-25,000 jewellery (**Chinese on line jewellery market has increased to 5-6% of total jewellery market in 2014 from mere 0.2-0.3% in 2006). PCJ is also going to launch its own e-commerce portal within next one month.** The company is also planning to expand via the franchise route of 1,000-1,500 sq ft in tier III cities. Also, on the anvil is launch of watches and silver gift items in stores priced at ~INR10,000 plus which will help capture higher wallet share of the existing customer.

Outlook and valuations: Sentiment improving; 'Not Rated'

Likely revival in growth led by upcoming marriage/festive season, improving sentiments and strong expansion plan augur well for PCJ. As urban recovery pans out, PCJ will clock high sales growth. We do not have a recommendation on the stock as it is currently not under our coverage.

Financials

Year to March	FY11	FY12	FY13	FY14
Revenues (INR mn)	19,771	30,419	40,184	53,248
Rev. growth (%)	*100.7*	*53.9*	*32.1*	*32.5*
EBITDA (INR mn)	1,989	3,315	4,818	5,863
Net profit (INR mn)	1,477	2,309	2,910	3,563
Shares outstanding (mn)	45	134	179	179
Diluted EPS (INR)	33.1	17.2	16.3	19.9
EPS growth (%)	*69.4*	*(47.9)*	*(5.7)*	*22.4*
Diluted P/E (x)	5.8	11.1	11.7	9.6
EV/EBITDA (x)	4.9	9.2	7.0	7.0
ROAE (%)	60.6	52.4	29.9	23.2

EDELWEISS RATINGS

Absolute Rating	NOT RATED

MARKET DATA *(R: PCJE.BO, B: PCJL IN)*

CMP	: INR 191
Target Price	: NA
52-week range (INR)	: 199 / 71
Share in issue (mn)	: 179.1
M cap (INR bn/USD mn)	: 34 / 560
Avg. Daily Vol.BSE/NSE('000)	: 538.1

SHARE HOLDING PATTERN (%)

	Current	Q4FY14	Q3FY14
Promoters %	70.5	70.5	70.0
MF's, FI's & BK's	2.9	3.0	2.9
FII's	11.1	13.0	13.6
others	15.4	13.5	13.5

** Promoters pledged shares (% of share in issue) : NIL*

RELATIVE PERFORMANCE (%)

	Sensex	Stock	Stock over Sensex
1 month	4.3	42.5	(38.2)
3 months	5.6	60.2	54.6
12 months	36.5	115.3	78.8

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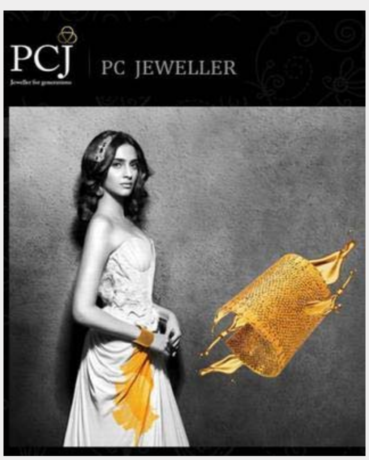
- **Balram Garg,**
MD, PC Jeweller



Meeting with PC Jeweller | Key takeaways

Guidance: PCJ has guided towards 25% sales growth (5% SSG, 20% new store growth) if gold rate remains stable. If it falls below INR25,000, sales will grow at 30% (10% SSG, 20% new stores) and if it is above INR30,000, sales growth will be 20%. PCJ aims to increase its dividend payout by 5% every year. The company is targeting addition of at least 20 stores per year over the next 3 years. PCJ aims to triple its sales by 2019 and to support organizational growth it has hired Hewitt for human resource planning. Accordingly, 80-90% of personnel needed, will be hired by FY15 end.

Q2FY15: All jewellery players are likely to clock 25% YoY growth in Q2FY15. Q3FY15 will see benefit of Diwali.

Gold sourcing: PCJ is importing 100% gold through banks viz., HDFC, Kotak, Nova Scotia, SBI and Corporation Bank.

Jewels for less: PCJ is reworking on a modified version of the *Jewels for less* (JFL) scheme, which is likely to be introduced in Q3FY15. JFL contributed only ~3% to sales as PCJ was a late entrant in this segment.

Studded jewellery: Studded share currently stands at ~29%, which PCJ plans to raise to 35%.

Gifting items: PCJ is planning to introduce watches and silver gift items in some of its stores to effectively use the existing space. The watches will be priced around INR10,000 plus primarily used for gifting during weddings; since the target audience is the same, these watches will help capture higher wallet share of existing customers at no extra cost.

Exploring on line model: PCJ is looking to tie up with Flipkart, Amazon and Sanpdeal to sell its product range on line. The company will introduce specialised collections unique to each portal under a sub-brand ranging from INR3,000-50,000 with higher focus on INR5,000-25,000 jewellery. It will offer 10-12% margin for diamond jewellery and 1-2% margin for gold jewellery to its on line partners. Products sold on line will be competitively priced to match prices in the store. PCJ expects on line to be a huge opportunity (Chinese on line jewellery market was mere 0.2-0.3% in 2006, which has surged to 5-6% in 2014). The company will get advertised on these on line portals and in turn will advertise for these on line partners. PCJ is also looking to tie up with Blueline (largest on line player in the world) to sell in India. **PCJ is also going to launch its own e-commerce portal within next one month.**

Jewellery manufacturing: Manufacture of gold jewellery is largely outsourced. Diamond jewellery is manufactured in house through machines (80%) and/or karigars (20%). PCJ is targeting in house manufacturing as it is cost effective and helps it to be differentiated on the design front. However, the company will still need to outsource ~30% of its needs.

Ad spends: PCJ currently spends ~1% on advertising and intends to maintain these levels.

Employee: PCJ has ~120 karigars, 40 designers (~10 of them are always on ground to study designs, competition, trends) and 20 CAD designers at its own manufacturing facility. Employees at the front end are paid salary on fixed plus variable basis where variable component is based on sales they clock (incentives are higher for diamond, slow moving items).

- **Sanjeev Bhatia,**
President- Finance, PC Jeweller

Wastages: 1-2% of gold gets wasted at the time of manufacture of diamond jewellery and ~0.5% gold gets wasted when making gold jewellery. PCJ has put in place a few processes to recover wasted gold like: (i) 150-200g of gold per month is recovered from burning discarded clothes of workmen (karigaars); and (ii) 250g of gold per six month is recovered from burning discarded carpets.

Exports: Exports have become essential for PCJ on account of 80:20 rule to support domestic business gold needs. The company makes ~8% gross margin and 3-4% EBITDA margin in exports. However, capital employed in the business is low (INR500-600mn) as it avails gold on lease (180 days credit) and gets credit on jewellery sales. Its exports are likely to stabilise at INR15bn per year. FY14 was the first year when the company conducted 4 exhibitions to promote exports.

SEZ: Unit produces solely for the purpose of exports. The gold imported for SEZ is not considered under the 80:20 rule. Though this a low margin business, PCJ is continuing operations as this does not require any additional capex and making profits (though miniscule).

Making charges: PCJ's making charge is a fixed amount per 10g. However, if the gold rate fluctuates beyond a particular limit, the company modifies making charges. Making charges are inversely proportional to gold rate change so as to maintain margin.

New stores: PCJ is looking to add 4 new stores in Q2FY15 and 6 each in Q3FY15 and Q4FY15; to add 0.1mn sq ft of retail space. By FY17, the company is targeting a total of 100 stores, of which 40% will be in tier I and II each and balance 20% in metros. PCJ will open one more store in Delhi (at Dwarka) as now it has largely covered the market with 8 stores.

New store capex: Capex needed to open a new store in metro is INR450mn (INR400mn towards inventory and INR50mn for capex), in tier I city it is INR270mn (INR250mn towards inventory and INR20mn for capex) and in tier II city it is INR200mn (INR180mn towards inventory and INR20mn for capex). 60% of all inventory is gold, which is self financed as gold is procured on lease. PCJ only needs to invest in 40% of the inventory (diamond).

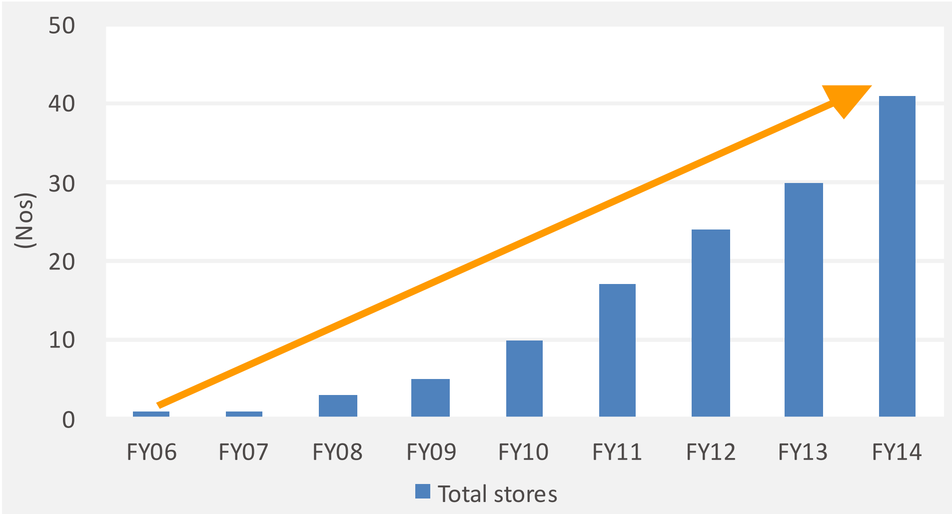
Franchisee stores: The company is looking to expand in tier III cities (population of 0.3-0.5mn) via the franchise route. Initially, the company will test waters with 2 pilots around New Delhi. The franchisee will have to invest INR50mn and its sales target will be INR100mn. Franchise stores will be 1,000-1,500 sq ft with expected 30% RoE. Revenue sharing will likely be 50:50. PCJ will outright sell inventory to the franchise. The franchise model will be restricted only to tier III cities where PCJ does not intend to open own stores.

Peer comparison: Titan is the largest jeweller in terms of profitability, followed by PCJ. Titan quotes gold rate at ~INR1,000 premium to PCJ (which sells at market rate) while other smaller brands/unorganized players sell at INR1,000 discount to PCJ.

Indian jewellery space: Indian jewellery, currently INR3tn market, is likely to expand to INR5tn in next 5 years. Currently, organized share in India is 20%; only 5% of players operate pan-India.

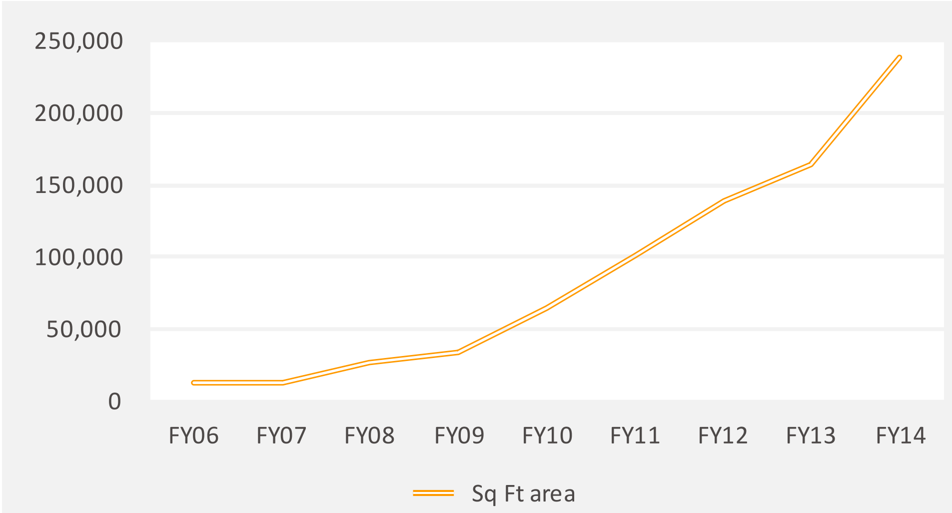
Gold imports: With 80:20 rule in place, the government has managed to contain CAD. Cut in import duty will only aid to curb smuggling to some extent. The government is only looking to curb investment demand of gold (half the gold imported in India was for investment). 25% surge in gold imports in neighbouring countries like Bangladesh suggests that significant amount of gold is being smuggled into India.

Chart 1: Total number of stores



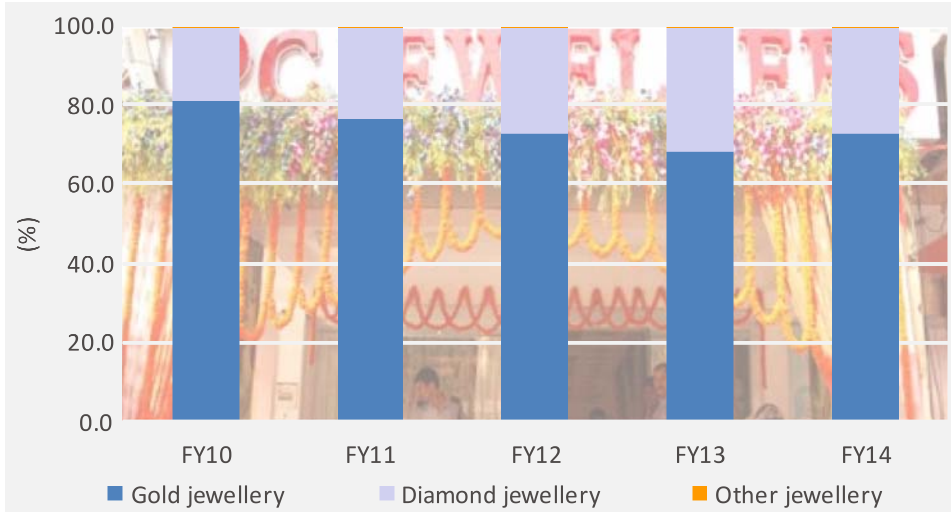
Source: Company

Chart 2: Total area in sq ft of stores



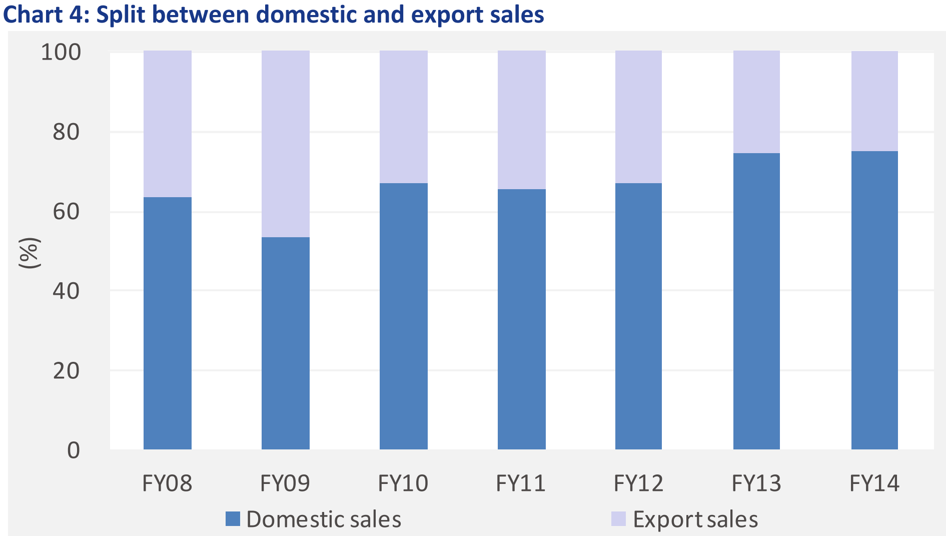
Source: Company

Chart 3: Split between diamond and gold jewellery



Source: Company

Chart 4: Split between domestic and export sales



Source: Company

Company Description

PCJ family is into the jewellery business since 1981. Starting operations from a single showroom in 2005, the company now has 45 showrooms located in more than 28 cities.

PCJ focuses on wedding jewellery with increasing contribution from high margin diamond jewellery (diamond jewellery contributes ~29%). The aggregate area of these stores is ~ 238,000 sq ft. PCJ has no plans to open stores in malls and will introduce franchise stores in tier III cities. The company remains focused on domestic retail operations, ~25% of its revenue comes from jewellery exports.

PCJ has its own 4 manufacturing facilities and significant portion of jewellery is manufactured in house (~6,230 kg gold processed in FY13). Some jewellery is also manufactured from independent contractors to take into account local tastes and customer preferences across different markets.

Key Risks

Regulatory hurdles: As gold is one of the key import articles, Government may take action to curb its demand thereby impacting the jewellery business by reducing demand and/or increasing costs like customs duty, lease rate, etc.

Deterioration of macro conditions: Poor macro outlook could lead to prolonged slowdown in the company's growth as the company's revenues depend on discretionary spend.

Volatility in gold prices: Gold prices have a significant bearing on gold demand. Any steep rise in prices results in lower demand, and investment buying that comes in is low margin.

Business seasonal, restricted to marriage season and festivals: The jewellery segment is seasonal with respect to marriage season and festivals. Additionally, the number of wedding dates varies in a year. This could impact the company's revenue.

Financial Statements

Income statement				(INR mn)
Year to March	FY11	FY12	FY13	FY14
Net revenues	19,771	30,419	40,184	53,248
Cost of materials	17,211	25,174	33,623	44,837
Gross profit	2,559	5,246	6,561	8,411
Employee costs	77	249	353	447
Advertisement & sales costs	123	264	262	500
Others	371	1,417	1,129	1,601
EBITDA	1,989	3,315	4,818	5,863
Depreciation	30	69	100	123
EBIT	1,959	3,246	4,718	5,740
Other income	168	172	206	472
EBIT incl. other income	2,127	3,418	4,924	6,213
Net interest & Finance charges	496	772	1,275	1,519
PBT	1,631	2,646	3,649	4,694
Provision for taxation	183	337	739	1,131
Core PAT	1,449	2,309	2,910	3,563
Extraordinary items (net of tax)	28.2	-	-	-
Pro. Aft. tax after mino.int. & Ass	1,477	2,309	2,910	3,563
Equity shares outstanding (mn)	44.7	134.0	179.1	179.1
EPS (INR) basic	33.1	17.2	16.2	19.9
Diluted shares (mn)	44.7	134.0	179.1	179.1
EPS (INR) fully diluted	33.1	17.2	16.3	19.9
CEPS (INR)	33.1	17.8	16.8	20.6
Tax rate (%)	11.2	12.7	20.2	24.1

Common size metrics (%)				
Year to March	FY11	FY12	FY13	FY14
Cost of materials	87.1	82.8	83.7	84.2
Employee costs	0.4	0.8	0.9	0.8
Advertising & sales costs	0.6	0.9	0.7	0.9
Other general expenditure	1.9	4.7	2.8	3.0
Depreciation	0.2	0.2	0.2	0.2
Net interest expenditure	2.5	2.5	3.2	2.9
EBITDA margin	10.1	10.9	12.0	11.0
EBIT margin	9.9	10.7	11.7	10.8
Net profit margin	7.3	7.6	7.2	6.7

Growth metrics (%)				
Year to March	FY11	FY12E	FY13	FY14
Revenues	100.7	53.9	32.1	32.5
EBITDA	102.0	66.7	45.3	21.7
PBT	113.1	62.2	37.9	28.6
Net profit	118.0	59.4	26.0	22.4
EPS	69.4	(47.9)	(5.7)	22.4

Balance sheet				(INR mn)
As on 31st March	FY11	FY12	FY13	FY14
Share capital	447	1,340	1,791	1,791
Reserves	2,810	4,215	12,097	15,031
Shareholders' funds	3,257	5,554	13,888	16,822
Long term borrowings	14	22	12	4
Short term borrowings	1,377	5,751	2,309	10,030
Borrowings	1,390	5,773	2,321	10,034
Sources of funds	**4,647**	**11,327**	**16,209**	**26,856**
Tangible assets	317	628	658	869
Intangible assets	8	10	10	11
Total net fixed assets	325	638	668	880
Deferred tax asset (net)	5	4	50	107
Current investments	-	-	4,429	1,849
Cash and cash equivalents	191	749	2,649	3,301
Inventories	5,495	11,724	17,137	23,771
Sundry debtors	4,248	6,866	6,748	6,232
Loans & advances	378	862	2,500	5,884
Other assets	147	100	201	908
Total current assets (ex cash)	10,267	19,581	26,556	36,766
Trade payable	5,893	8,525	16,250	12,841
Other current liabilities and pro	248	1,121	1,892	3,206
Total current liabilities & provis	6,141	9,645	18,143	16,047
Net current assets (ex cash)	4,126	9,935	8,413	20,718
Uses of funds	**4,647**	**11,327**	**16,209**	**26,856**
BV (INR)	73	41	78	94

Free cash flow				(INR mn)
Year to March	FY11	FY12	FY13	FY14
Net profit	1,477	2,309	2,910	3,563
Add: Non cash charge	418	1,024	1,497	(11,660)
Depreciation	30	69	100	123
Others	389	955	1,397	(11,783)
Gross cash flow	1,895	3,333	4,407	(8,097)
Less:Changes in WC	2,188	6,700	(793)	-
Cash from operations	(293)	(3,366)	5,200	(8,097)
Less: Capex	141	500	237	317
Free cash flow	(434)	(3,867)	4,963	(8,414)

Cash flow metric				
Year to March	FY11	FY12	FY13	FY14
Operating cash flow	(293)	(3,366)	5,200	(8,097)
Financing cash flow	192	3,589	1,405	5,948
Investing cash flow	(116)	(300)	(5,921)	2,462
Change in cash	(217)	(77)	685	313
Capex	(141)	(500)	(237)	(317)
Dividends paid	-	-	(149)	(223)
Share issuance/(buyback)	45	893	451	-

Ratios

Year to March	FY11	FY12	FY13	FY14
ROAE (%)	60.6	52.4	29.9	23.2
ROACE (%)	56.1	40.6	34.3	26.7
Debtor days	62	67	62	44
Inventory days	98	125	157	167
Payable days	107	99	130	114
Cash conversion cycle (days)	54	93	88	97
Current ratio	1.7	2.1	1.6	2.5
Debt/EBITDA	0.7	1.7	0.5	1.7
Debt/Equity	0.4	1.0	0.2	0.6
Interest coverage (x)	4.0	4.2	3.7	3.8

Valuation parameters

Year to March	FY11	FY12	FY13	FY14
Diluted EPS (INR)	33.1	17.2	16.3	19.9
Y-o-Y growth (%)	69.4	(47.9)	(5.7)	22.4
CEPS (INR)	33.1	17.8	16.8	20.6
Diluted P/E (x)	5.8	11.1	11.7	9.6
Price/BV (x)	2.6	4.6	2.5	2.0
EV/Sales (x)	0.5	1.0	0.8	0.8
EV/EBITDA (x)	4.9	9.2	7.0	7.0

Operating ratios

Year to March	FY11	FY12	FY13	FY14
Total asset turnover	5.7	3.8	2.9	2.5
Fixed asset turnover	73.2	63.1	61.5	68.8
Equity turnover	8.3	6.9	4.1	3.5

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Coverage group(s) of stocks by primary analyst(s): Retail

Future Retail, Jubilant Foodworks, Shoppers Stop, Titan Industries

Recent Research

Date	Company	Title	Price (INR)	Recos
26-Aug-14	**Marico Kaya Enterprises**	'Cure' to attract, 'care' to retain; *Visit Note*	488	Not Rated
08-Aug-14	**Jubilant Foodworks**	Working hard, but payback to be delayed; Result Update	1,126	Buy
01-Aug-14	**Shoppers Stop**	Same store growth optically low; likely to improve; Result Update	391	Buy

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution* * 1 stocks under review	151	44	9	205

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	144	56	5

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

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