Emkay
Your success is our success

PC Jeweller

Reaching Small for Winning Big

CMP	Target Price
Rs367	Rs490 (▲)
Rating	**Upside**
BUY (▲)	33.2 %

- Healthy 15.5% revenue CAGR, strong earnings CAGR of 25%, good competitive standing, fading regulatory headwinds and better disclosures in the export segment are likely to drive higher free cash flows and improved return ratios
- Domestic business is 72% of sales and the key driver for PCJ. Shift to branded jewellery, fading regulatory headwinds, store expansion and likely revival in urban demand are key catalysts. We expect a 20% CAGR in domestic sales over FY15-18E
- Increase in proportion of diamond jewellery in revenue mix and likely uptick in SSG are key levers for margin expansion. We expect EBITDA margins to expand by 121 bps to 12.6% by FY18E
- We have valued PCJ on SOTP basis. We have assigned 16x P/E FY17E multiple to domestic business (40% discount to Titan) and 5x P/E to exports business (in line with peers), our target price works out to 490/share. We initiate coverage on PCJ with a BUY rating

Transforming into a leading national jeweller

PC Jeweller (PCJ) has strongly established itself as a leading player in North India and Central India and is aiming at a pan India presence, with current network of 53 stores across 45 cities. PCJ's revenues have grown at 45% CAGR over FY10-15 led by wedding demand, store expansion and rising gold demand. Domestic business has grown at 47% CAGR with gold jewellery at 42% CAGR and diamond jewellery growing faster at 65% CAGR over FY10-15.

Domestic business has multiple growth drivers; Is the key catalyst for PCJ

Domestic business accounts for 72% of revenues and has grown at 47% CAGR over FY10-15 driven by store expansion & wedding demand. We expect domestic segment to grow at 20% CAGR over FY15-18E driven by: i) shift to branded jewellery ii) favourable income & consumption demographics iii) square feet addition of 100,000 sq ft over 5 years iv) uptick in urban demand. Success of the franchisee model will give further upsides to our assumptions.

Margin levers – Increasing share of diamond jewellery & SSG revival

Rising diamond share (32% of domestic sales) and sustained SSG had led margin uptick till FY14, but margins were hit by flat SSG in FY15. We expect share of diamond jewellery to go up to 40% of domestic revenues by FY18, while higher SSG growth will trigger operating leverage, thereby driving margin expansion. We expect 12.6% EBITDA margins by FY18.

A strong, sustainable domestic growth story; Initiate with BUY

We expect PCJ's reduced focus on low margin export segment and increased investments & efforts on domestic business to pay off with domestic segment growing at 20% over FY15-18E. Subsequently, we expect strong profitability, higher free cash flow and better return ratios. We have valued PCJ on SOTP basis assigning P/E FY17E multiples of 16x to the domestic business (40% discount to Titan) and 5x to its exports business (in line with peers), our target price works out to 490/share. We initiate coverage on PCJ with a BUY rating.

Financial Snapshot (Standalone)

(Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	53,248	63,485	75,655	86,754	97,891
EBITDA	5,817	7,240	8,927	10,494	12,345
EBITDA Margin (%)	10.9	11.4	11.8	12.1	12.6
APAT	3,563	3,782	4,774	5,968	7,387
EPS (Rs)	19.9	21.1	26.7	33.3	41.2
EPS (% chg)	22.6	6.2	26.2	25.0	23.8
ROE (%)	23.2	20.6	21.8	22.5	23.0
P/E (x)	18.4	17.4	13.8	11.0	8.9
EV/EBITDA (x)	12.1	9.6	7.5	6.3	5.2
P/BV (x)	3.9	3.3	2.7	2.3	1.9

Source: Company, Emkay Research

Change in Estimates	
EPS Chg FY16E/FY17E (%)	NA/NA
Target Price change (%)	NA
Previous Reco	NA

Emkay vs Consensus

EPS Estimates	FY16E	FY17E
Emkay	26.7	33.3
Consensus	-	-
Mean Consensus TP		-

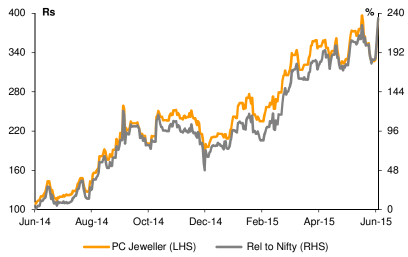
Stock Details	
Bloomberg Code	PCJL IN
Face Value (Rs)	10
Shares outstanding (mn)	179
52 Week H/L	408 / 110
M Cap (Rs bn/USD bn)	66 / 1.03
Daily Avg Volume (nos.)	381,387
Daily Avg Turnover (US$ mn)	2.3

Shareholding Pattern Mar '15	
Promoters	70.6%
FIIs	17.7%
DIIs	0.2%
Public and Others	11.6%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(2)	8	79	228
Rel. to Nifty	(4)	10	77	196

Relative price chart



Source: Bloomberg

Prashant Kutty
prashant.kutty@emkayglobal.com
+91 22 66121341

Sameep Kasbekar, CFA
sameep.kasbekar@emkayglobal.com
+91 22 66121281

Investment Rationale

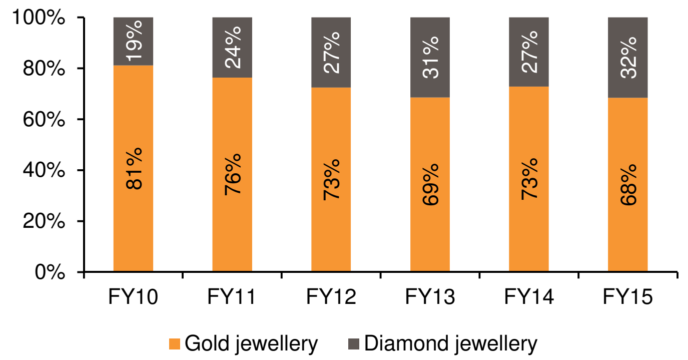
Domestic jewellery business – A combination of consumption & innovation-led growth

- PC Jeweller (PCJ) has transformed itself from a regional brand to a leading player in the organised jewellery space. In FY15, domestic business revenue contributed 72% to sales vs 66% in FY10. It has grown at a 47% CAGR over FY10-15, primarily led by store expansion.
- There are multiple growth drivers for the organised jewellery market: i) increasing shift from unorganised jewellers to branded/organised jewellers, ii) rising urbanisation, iii) increasing disposable income leading to higher consumption, and iv) likely uptick in demand sentiments. We believe PCJ is well-placed to ride the consumption-led growth.
- Apart from industry growth drivers, we believe, PCJ's growth strategy of i) aggressive store expansion via own and franchisee route, especially in Tier 2/3 cities and ii) innovation via new products like Flexia, low Karat jewellery, diamond in silver, etc will reap rich dividends for its domestic business.
- We expect the domestic business to grow at 19.9% CAGR over FY15-18E to Rs 78.2bn, with 14.6% growth in gold and 30% growth in diamond jewellery.

Quick transformation from a regional player to a leading national brand

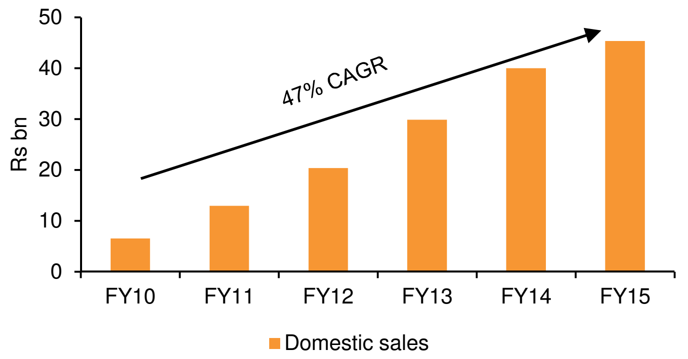
PCJ, after establishing itself as a strong force in North India and Central India, has expanded its wings to other parts of the country. From a single showroom in Karol Bagh, Delhi in FY05, it has expanded at a rapid pace, with its network rising to 53 large format stores with presence in 45 cities and 17 states. Its domestic business has grown at a rapid pace of 47% CAGR over FY10-15, with gold jewellery growing at 42% CAGR and diamond jewellery growing faster at 65% CAGR over the same period. Store expansion coupled with wedding demand and sustained demand for gold has led to a strong growth trajectory for PCJ.

Exhibit 1: Improving diamond mix in domestic jewellery segment



Source: Company, Emkay Research

Exhibit 2: Domestic sales FY10-FY15 CAGR of 47%



Source: Company, Emkay Research

Multiple growth drivers in place to ride the domestic jewellery segment

PCJ is well placed to gain from the favourable industry growth drivers of rising shift to organised jewellery, increasing urbanisation and higher disposable income. PCJ also plans to tap the growing organised jewellery market by aggressive store expansion in Tier I and II cities via own and franchisee route and innovation-led growth. We consider the below mentioned factors to be pivotal for PCJ's sustained growth trajectory in the domestic jewellery business.

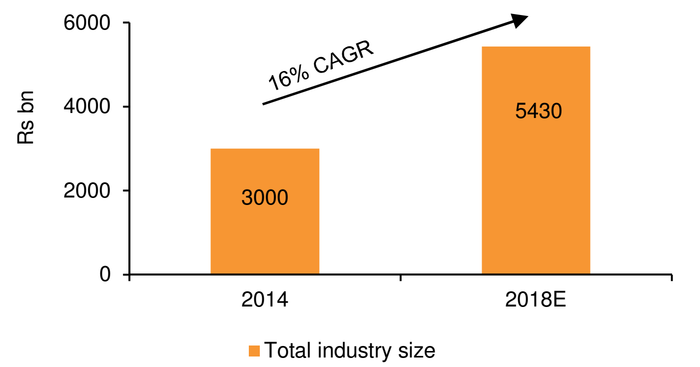
- Rising shift from unorganised jewellers to branded/organised jewellers,
- Rising urbanisation
- Increasing disposable income, leading to higher consumption,
- Likely uptick in demand sentiments
- Aggressive store expansion via own and franchisee route, especially in Tier 2/3 cities; and
- Innovation-led growth

Shift to branded/organised jewellery – growing at a fast pace

Over the years, the share of organised gems & jewellery industry has risen at a healthy pace from $23.4bn in FY09 to $50bn in FY14, growing at 16% CAGR. Of that, the share of the organised gems & jewellery sector, which includes both national and regional players, has risen from 10% in FY09 to about 22% in FY14 (national chains – from 3% to 5% and regional chains – from 7% to 17%). As per industry reports, over the next four years, the gems & jewellery industry is expected to grow at a sustained pace of 16% to $90bn by FY18 and the share of organised jewellery is expected to rise sharply to 35%. The size of the organised market is currently about ~Rs 660 bn and if industry estimates are to be achieved, the organised market would have to grow at 30% CAGR to reach about Rs 1,900bn.

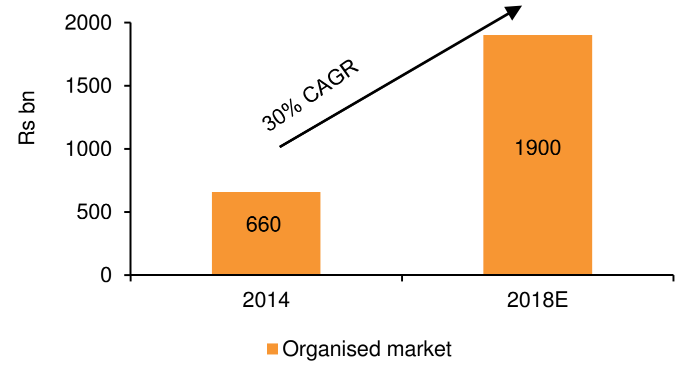
Increasing awareness among consumers about branded jewellery, quality focus and hall-marking has aided faster shift towards organised jewellery. Given the rising presence of PCJ and it being the 2nd largest listed national player with 7% market share in the organised jewellery space, we expect PCJ to be a bigger beneficiary of the rising organised market.

Exhibit 3: Total industry expected to grow at 16% CAGR



Source: Company, Emkay Research, Industry

Exhibit 4: Organised market expected to grow at a faster pace



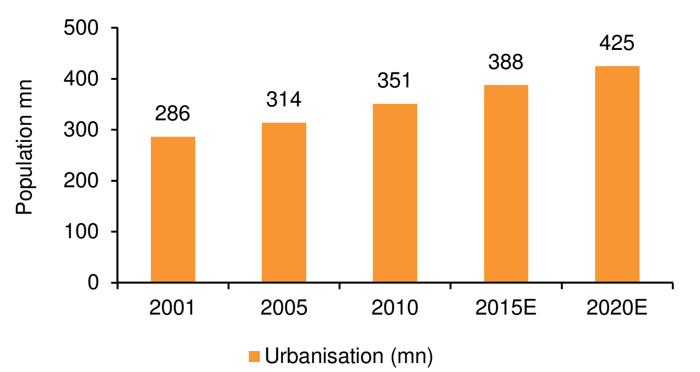
Source: Company, Emkay Research, Industry

Favourable demographic profile driving income, aspiration & consumption

We believe India's strong demographic profile has been one of the key drivers for sustained growth in organised formats. Factors like rise in disposable income, increasing urbanisation, changing lifestyle with greater exposure to global fashion/tastes and rise in discretionary spends have been pivotal factors for healthy growth of organised sector. While consumer spending has taken a temporary hit, we believe long term drivers are intact.

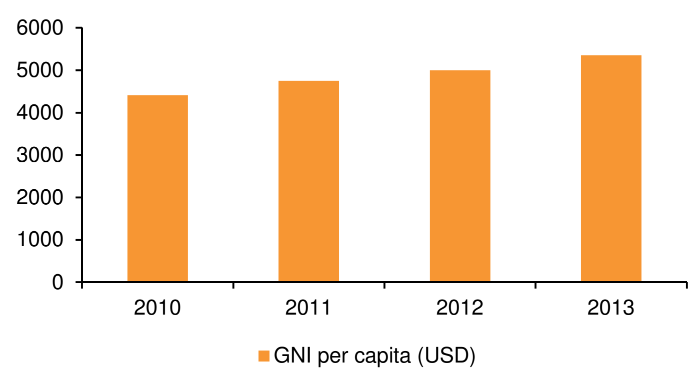
Income - The urban population, which accounted for 30% of total population in 2010, is expected to rise to 40% in 2030. Thus, rapidly rising household incomes, coupled with urbanization of Indian population would lead to jump in overall consumer spending.

Exhibit 5: Growing urbanisation in India



Source: D&B India, Emkay Research

Exhibit 6: Gross National Income has been on the rise as well

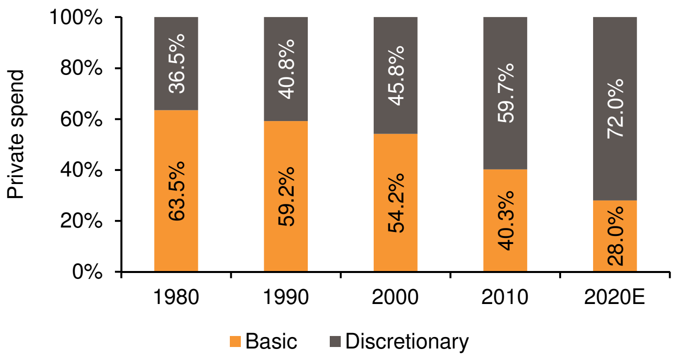


Source: World Bank, Emkay Research

Aspiration - Branded jewellery has an aspirational value for the evolving Indian consumer. Further, the rise of organized retail has led to faster proliferation and distribution of branded jewellery, providing convenience of trade for branded jewellery.

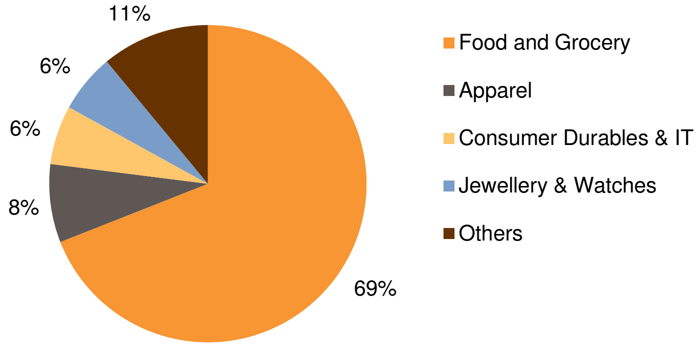
Consumption – The penetration of branded jewellery is abysmally low as this market is largely dominated by un-organised players. But branded jewellery is gaining importance as consumption pattern is changing towards aspiration products and brand association.

Exhibit 7: Growing share of discretionary spending



Source: D&B India, Emkay Research

Exhibit 8: Break down of retail market

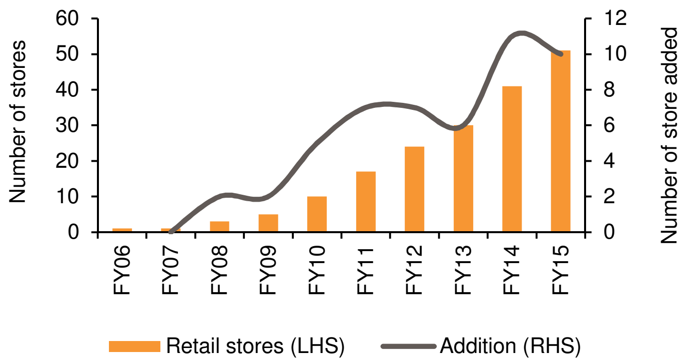


Source: Technopak, Emkay Research

Store expansion at a rapid pace aimed at steadfast growth & market share gains

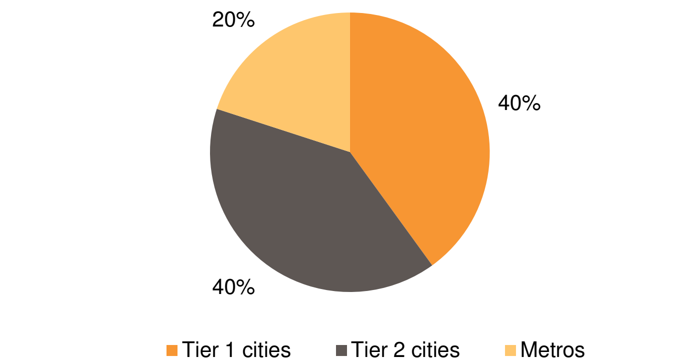
One of the key drivers for PCJ's rapid growth of 45% CAGR over FY08-15 has been aggressive pace of store expansion via large format stores (average 4,000-5,000 sq ft). In the last 8 years, PCJ has added an average of 7 stores a year, taking its total tally to 51 stores and 312,296 sq ft retail space as of FY15. The expansion was far more aggressive in the last 2 years, with 27 stores added during FY13-15. PCJ's retail space addition has grown at 37% CAGR over FY10-FY15. All of its stores are large format stores and in majority of the locations, its store is the largest compared to other jewellers in that area. PCJ focuses on wedding jewellery, which is a significant portion of domestic revenues, and thus, having larger size stores increases trust factor of the consumer.

Exhibit 9: Store addition has been aggressive in last 3 years



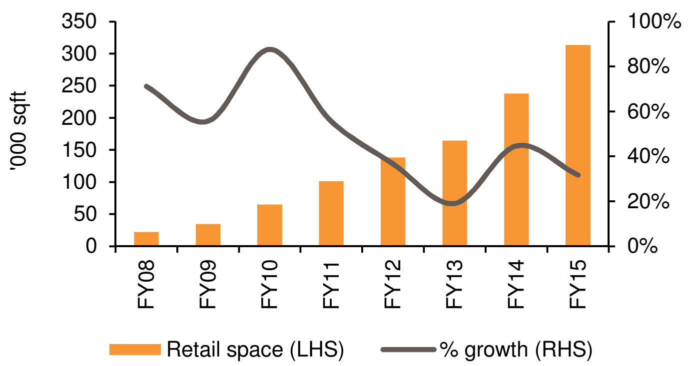
Source: Company, Emkay Research

Exhibit 10: Store addition more skewed towards Tier I & II cities



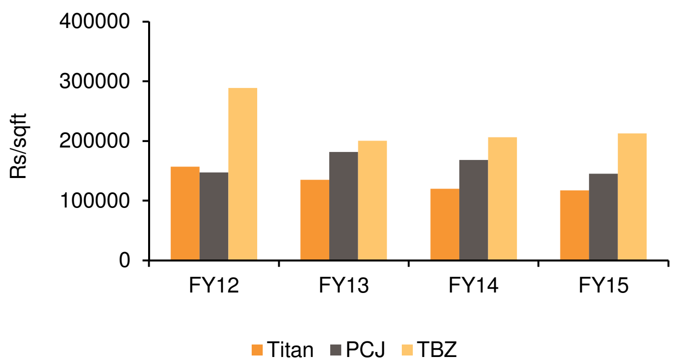
Source: Company, Emkay Research

Exhibit 11: Space addition has grown at 37% CAGR over FY08-15



Source: Company, Emkay Research

Exhibit 12: PCJ enjoys a healthy revenue/sq ft vs peers



Source: Company, Emkay Research

PCJ has focused on expanding its footprints in Tier I & Tier II cities, where there is high prominence of unorganised jewellers. This expansion strategy gives them an edge over competition, as it is able to establish its presence in many cities ahead of its peers. About 40% of PCJ's stores are located in Tier I cities and another 40% in Tier II cities. PCJ has limited exposure in metros, with only 20% of their stores located in metros. This cluster based approach of expanding presence in Tier I & II has enabled the company to establish itself in the Northern region and gain from increasing equity of the brand, 'PCJ'.

Exhibit 13: Competitor presence at PCJ store locations

PCJ presence	State	Population	Tier	Tanishq	TBZ	Kalyan	Other prominent Regional/Local players
Ahmedabad	Gujarat	5,570,585	Metro	✓	✓	✓	Anjalee Jewellers, AB Jewellers
Ajmer	Rajasthan	542,580	Tier 2	✓			RR Jewellers, Tara Jewellers
Amritsar	Punjab	1,132,761	Tier 1	✓		✓	Nagi Diamond Jewellers, Maliram Jewellers, Goggi Jewellers
Bareilly	UP	898,167	Tier 2				HS Jewellers, Laxmi Jewellers
Beawar	Rajasthan	145,809	Tier 2				Swarn Ganga Jewellers
Bengaluru	Karnataka	8,425,970	Metro	✓		✓	Bhima Jewellers, Prince Jewellert, Abaran Jewellers
Bhilwara	Rajasthan	360,009	Tier 2				BM Jewellers, Shrinath Jewellers
Bhopal	MP	1,795,648	Tier 1	✓			Akshay Jewellers, Alark Jewels, Orra
Bilaspur	Chattisgarh	330,106	Tier 2	✓			Shri Ram Jewellers
Chandigarh	Punjab	960,787	Tier 1	✓			Talwar Sons Jewellers, Jain Jewellers
Dehradun	Uttarakhand	578,420	Tier 1	✓			Kamal Jewellers, Standard Jewellers, Frontier Jewellers
Faridabad	Haryana	1,404,653	Tier 1	✓			SRS Jewellers, Om Sons Jewellers
Sriganganagar	Rajasthan	224,773	Tier 2	✓			Rawalpindi Jewellers, Setoa Jewellers
Ghaziabad	UP	1,636,068	Tier 1	✓			D'damas, Rawalpindi Jewellers
Gurgaon	Haryana	876,824	Tier 1	✓		✓	Shri Ram Jewellers, Bhola Sons Jewellers
Guwahati	Assam	963,429	Tier 1	✓			MP Jewellers, Manik Chand & Sons
Haridwar	Uttarakhand	225,235	Tier 2	✓			Gayathri Jewellers, Bal Sons Jewellers
Hisar	Harayana	301,249	Tier 2				Jain Jewellers, Mohit Jewellers
Hyderabad	AP	7,170,545	Metro	✓	✓	✓	Sri Krishna Jewellers, Narayani Jewellers
Indore	MP	1,960,631	Tier 1	✓	✓		Divine Jewellers, Interstar Jewellers
Jabalpur	MP	1,054,336	Tier 1	✓			Alankar Jewellers, Kothari Jewellers
Jaipur	Rajasthan	3,073,350	Tier 1	✓			Surana Jewellers, Vatika Jewellers, Motisons Jewellers
Jammu	J&K	503,690	Tier 1	✓			Rakesh Jewellers, Talla Jewellers
Jodhpur	Rajasthan	1,033,918	Tier 1	✓			Dwarika Jewellers, Swarn Prabha Jewellers
Kanpur	UP	2,767,031	Tier 1	✓			Kashi Jewellers, Baijnath Ramkishore Jewellers
Kolkata	West Bengal	4,486,679	Metro	✓	✓		Anjali Jewellers, BC Sen Jewellers
Lucknow	UP	2,815,601	Tier 1	✓			TP Jewellers, BNTK Jewellers, Lucky Jewellers
Ludhiana	Punjab	1,613,878	Tier 1	✓		✓	Ganpati Jewellers, Heritage Jewellers
Mangalore	Karnataka	484,785	Tier 2			✓	Abharan Jewellers, Orra Jewellery
Mathura	UP	349,336	Tier 2	✓			Shri Ji Jewellers, Koshda Jewellers
New Delhi	New Delhi	11,007,835	Metro	✓		✓	Mehra Sons Jewellers, Khanna Jewellers
Noida	UP	642,381	Tier 1	✓		✓	Manohar Lal Jewellers, RC Jewellers
Pali	Rajasthan	229,956	Tier 2				MP Jewellers, PB Jewellers
Panchkula	Haryana	210,175	Tier 1				Verma Jewellers, Dwarka Jewellers
Patna	Bihar	1,683,200	Tier 1	✓			Hira Panna Jewellers, Sevika Jewellers
Raipur	Chattisgarh	1,010,087	Tier 1	✓	✓		Sumeet Jewellers, Dharam Jewellers
Rajkot	Gujarat	1,286,995	Tier 2	✓	✓	✓	Lotus Jewellers, Vraj Jewellers
Ranchi	Jharkhand	1,073,440	Tier 1	✓			Tulsyan Jewellery, Kuldip Son Jewellers
Rohtak	Haryana	373,133	Tier 2	✓			Giriraj Jewellers, Bawa Jewellers
Vadodara	Gujarat	1,666,703	Tier 1		✓	✓	CH Jewellers, Damodardas Jewellers
Varanasi	UP	1,201,815	Tier 2	✓			Chetmani Jewellers, Narayan Das Jewellers

Source: Company, News articles, Emkay Research

This cluster based approach of expansion is operationally beneficial for the company, as it is able to achieve faster break-even vs opening a new store in a completely new region. This is evident from the exhibits below.

Exhibit 14: Economics are favourable for new store in existing city

Store Type	Breakeven time period
New store in existing city	< than 6 months
New store in same region/state as existing city	6-9 months
New store in a completely new region	Equal or above 1 year

Source: Emkay Research, Company

Exhibit 15: Store matrix by geography; Tier 2 cities have the quickest break-even period

	Metro	Tier 1	Tier 2
Size (sq ft)	10,000	5,000-7,000	4,000-5,000
Capex (Rs mn)	50	30	20
Inventory (Rs mn)	400-800	250-300	180-220
Breakeven (months)	14-16	8-10	6

Source: Company, Emkay Research

Given the huge opportunity for branded players in the jewellery space, PCJ remains aggressive on its network expansion targets. The company plans to add an average 100,000 sq ft per year over the next 5 years. In line with its strategy, store addition will be 40% in Tier I cities, 40% in Tier II cities and balance 20% in metros/urban centres. There is enough potential for growth in East, North & Central India. Company is less focused on South India, as they are high plain gold jewellery markets.

Exhibit 16: A detailed peer analysis of listed players in the domestic jewellery segment

FY15 - Rs mn	Titan	TBZ	PCJ
Revenue*	**94300**	**19342**	**45387**
CAGR FY10-FY15 (%)	21.9%	16.9%	47.3%
Revenue/sq ft (FY12)	156981	288809	147496
Revenue/sq ft (FY15)	116998	212414	144869
Total store area FY12 (sq ft)	450000	47796	138274
Total store area FY15 (sq ft)	806000	91058	313296
Number of stores FY12 (nos)	163	14	24
Number of stores FY15 (nos)	207	28	51
Mix			
Gold (%)	68.0%	75.3%	68.5%
Diamond (%)	32.0%	22.4%	31.5%
EBITDA Margin (%)	**10.0%**	**4.3%**	**13.3%**
Inventory days*	121	210	198
Debtors days*	5	0	1
Creditors days	80	99	107
OCF			
FY13	5531	-3218	4362
FY14	-5513	-718	-9044
FY15	5623	-304	1937
FCF			
FY13	3905	-3676	4125
FY14	-7585	-907	-9325
FY15	3658	-501	1650
ROCE (%)	**34.8%**	**5.4%**	**28.5%**

Source: Company, Bloomberg, Emkay Research
** - Revenue, inventory & debtor cycle is for domestic jewellery business*

Entering smaller towns via franchisee route – Asset light model enabling faster reach

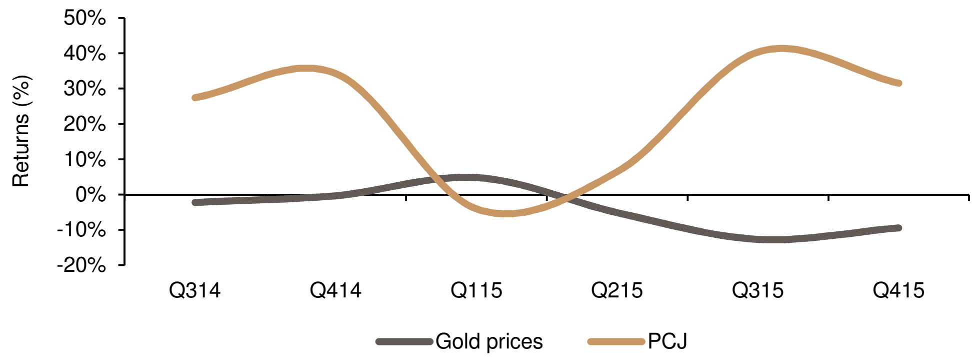
PCJ is expanding its footprints in the smaller towns/cities via the franchisee route, which is likely to further accentuate its brand equity. PCJ plans to tie up with local jewellers, who want to associate themselves with a brand in order to expand their business horizon. As per the arrangement, PCJ will not have any capital commitment, except bearing advertisement/ marketing cost. PCJ will sell jewellery to the franchisee at a lower mark up and will have a 50:50 mark-up sharing agreement with the franchisee.

The total capital employed at the store level is estimated to be Rs 330mn, of which, store set up cost constitutes 7% and the balance 93% is inventory. This would be an asset light business for PCJ and would be ROCE accretive for the company. PCJ will pilot this project in FY16 and plans to open 200 franchise stores over the next five years. **We have not factored any impact of franchisee addition to our estimates.**

Likely uptick in urban consumption to drive SSG

Benign consumer sentiments, especially in urban markets, led to lower demand for discretionary categories. Moreover, rising regulatory headwinds further impacted growth of organised jewellers. Domestic revenue growth had tapered from 40% CAGR during FY12-FY14 period to 13% in FY15, despite fall in gold prices. Gold prices in the last 2 years have witnessed a declining trend, with prices falling by about 12-15% from the peak of Rs 3,100/gm to about Rs 2,650/gm. However, we believe that urban demand sentiments are likely to bottom out and we expect gradual recovery from hereon. Given the steady demand from wedding season and likely uptick in urban demand, we expect SSG trends to improve in ensuing quarters. The gold prices have stabilised and company believes this should enable them to sustain their growth trajectory in the coming years. Company has guided for 7-8% SSG in FY16 and we believe that PCJ is likely to achieve its SSG guidance.

Exhibit 17: Gold price increase vs PCJ sales growth – an inverse relation



Source: Company, Bloomberg, Emkay Research

Strong in-house capabilities driving innovation

Over the years, PCJ has developed strong manufacturing capabilities with over four jewellery units- 2 in SEZ locations in Noida, one non-SEZ in Noida and one in Dehradun, Uttrakhand. The manufacturing ability of the company is augmented by a 50 member strong team of designers. PCJ retail stores are also equipped with video calling facilities, where customers can chat with designers to order personalised designs in jewellery. To enhance customer trust, PCJ also follows a unique customer policy, where, it offers a 7-day return policy with full cash return and some other benefits include free repair and 30-day exchange window.

Given its strong capabilities, company is able to develop various unique concepts and designs. Company claims that its stores contain more variety and range vs competition. Few of the recent innovations launched by PCJ are using low karat gold jewellery, diamond jewellery in silver and flexible jewellery (Flexia). Flexia is a new range of jewellery, introduced only by PCJ, wherein a jewellery set can be converted and worn in multiple ways (5-6 ways). The initial response to the Flexia range has been very encouraging and company is targeting the youth and working women through this range.

PCJ, like other large jewellers, has installed Karatmeter for gold jewellery in all their stores, which gives exact purity of the jewellery, while for diamond jewellery, it provides quality certificates. All these initiatives are aimed at enhancing consumer confidence and trust of PCJ as a quality focused jeweller.

Exhibit 18: Flexia range - Aasra

Source: Company, Emkay Research

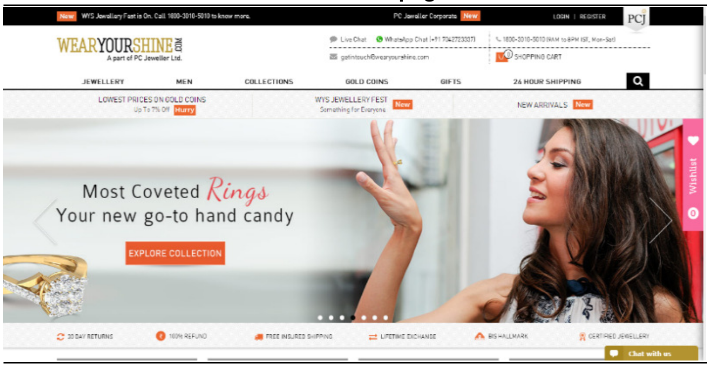
Exhibit 19: Flexia range - Adira

Source: Company, Emkay Research

E-commerce initiative – feedstock for healthy growth in the long term

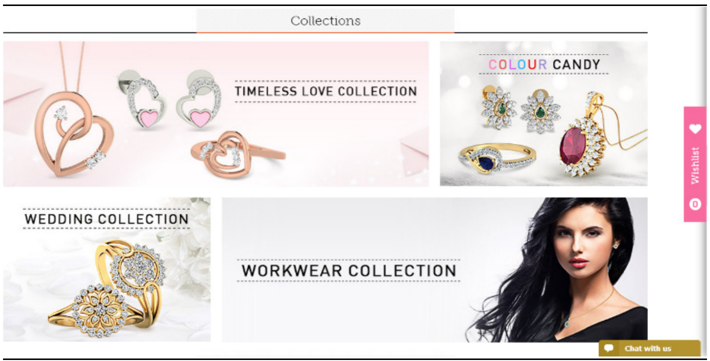
Keeping abreast with the current trends of online retailing, PCJ has entered the e-commerce segment through their website, WearYourShine.com. The average ticket size ranges between Rs 3,000 - Rs 50,000 and the company is targeting the work-wear segment. They expect increased traction from working women in this segment, thereby increasing brand loyalty. Company believes that over the long term, strong brand recall and loyalty will translate into wedding jewellery purchases. The company also has a tie up with Amazon, Flipkart and Snapdeal for online jewellery sales. They have also recently done a tie up with Blue Nile (one of the largest global players in the online jewellery space) to launch an exclusive jewellery range in India. The website, within the first 6 months, has witnessed strong traction.

Exhibit 20: WearYourShine.com home page



Source: Company, Emkay Research

Exhibit 21: WearYourShine.com collections



Source: Company, Emkay Research

Our assumptions for the domestic business; Expect 20% CAGR over next 3 years

Regulatory headwinds and weak demand sentiments resulted in flat SSG in FY15, but SSG saw some uptick in demand in the second half of the year. The company expects to post a modest 7-8% SSG in FY16. For mature stores, company will try to optimise growth by focusing on product mix improvement (increase share of diamond jewellery). We expect PCJ to maintain healthy revenue growth on the back of aggressive store addition, innovation-led growth and likely uptick in SSG, led by improving demand sentiments.

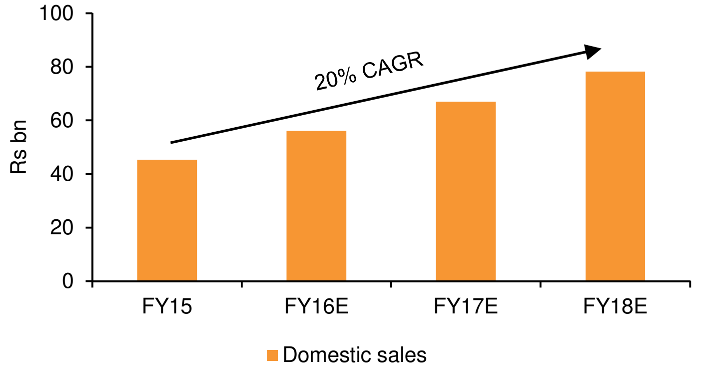
We have assumed domestic revenue CAGR of 20% for FY15-18E. We expect the share of diamond jewellery to considerably improve from 31.5% of total domestic sales in FY15 to 40.2% in FY18E.

Exhibit 22: Domestic business assumptions

Assumptions	FY15	FY16E	FY17E	FY18E
Revenue	45387	56131	67032	78219
Revenue growth	13.4%	23.7%	19.4%	16.7%
EBITDA	6049	7365	8932	10804
EBITDA growth	58.1%	21.8%	21.3%	21.0%
EBITDA margin	13.3%	13.1%	13.3%	13.8%
PAT	3128	4041	5233	6666
PAT growth	39.1%	29.2%	29.5%	27.4%
PAT margin	6.9%	7.2%	7.8%	8.5%

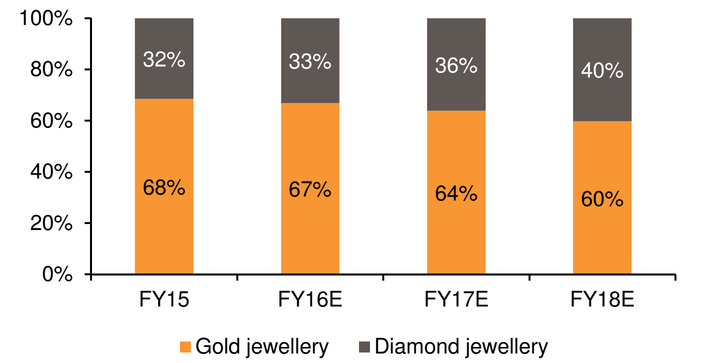
Source: Company, Emkay Research

Exhibit 23: Expect 20% revenue CAGR in domestic segment



Source: Company, Emkay Research

Exhibit 24: Domestic sales mix - diamond share on the rise



Source: Company, Emkay Research

A stable gold price environment would improve demand sentiments and success in the franchise model could be possible upsides to our assumptions.

Export segment – Higher disclosures aimed at addressing investor concerns

- Export segment is an overhang on valuations, due to its low margin, high debtors cycle and lack of clarity on business operations.
- The export segment remains a low focus area for PCJ, given limited growth opportunities. However, PCJ plans to maintain the current scale in this segment as it provides synergies to their domestic jewellery segment.
- Further, company is increasing disclosures in the export segment by separately disclosing the profitability and working capital schedule, which should provide better clarity to investors.
- We expect the export business to grow at a tepid 2.8% CAGR FY15-18E with overall revenue share falling to 20.1% in FY18E.

PCJ's export business is a B2B segment, primarily involving export of handmade designer gold jewellery and targeted at regions such as the Middle East, US and UK, which have a high presence of NRI population. While gold requirements for this segment are met through 'gold on lease' (270 days) mechanism, thereby protecting the inventory from any price risk, the high receivable cycle of 150-180 days is a concern for this business.

Due to the introduction of 80:20 scheme, the company had to increase exports to ensure availability of gold in domestic operations. As a result, the export business saw healthy growth of 33% CAGR in the last 2 years and due to increased orders from participation in international jewellery exhibition. Given the limited market potential for this business in the long term and low margin profile, the company may not focus on expanding this business. However, the company has made it clear that it would continue in this business due to synergy benefits with the domestic business (assured gold supplies in times of need & design capabilities).

The export segment is a low margin (7-8% EBIT margin) and has a high debtor cycle. However, due to 'gold on lease' mechanism, the return ratio profile of this segment is fairly reasonable at 18-20%. FY14 EBIT margin of 15% in this segment was an aberration due to unprecedented forex gains.

Company has been working on reducing its debtor days, which has come down from 169 days in FY14 to 152 days in FY15. Receivables as a % of sales has reduced from 46% in FY14 to 42% in FY15. While there is limited scope for any further reduction in receivable days, company aims to at least maintain it at current levels.

We expect the export business to grow at a tepid 2.8% CAGR over FY15-18E with overall revenue share falling 20.1% in FY18E.

One of the major overhang on valuations is the lack of clarity on the export segment. PCJ has been gradually increasing disclosures with respect to segment details (revenues & profitability), balance sheet details like loans, working capital cycle, etc. We believe that as the disclosure levels keep improving, it will allay investor fears and improve clarity on the segment's operating matrices. In a bid to further improve disclosure of this business, we believe, the company may consider de-merging this segment from the domestic business.

Two challenges this business faces are i) forex fluctuation and ii) high receivable days.

Exhibit 25: Working capital for exporters

	Inventory days		Debtors days	
Company	**FY14**	**FY15**	**FY14**	**FY15**
PCJ (exports division)	59	92	169	152
Rajesh Exports	7	5	30	16

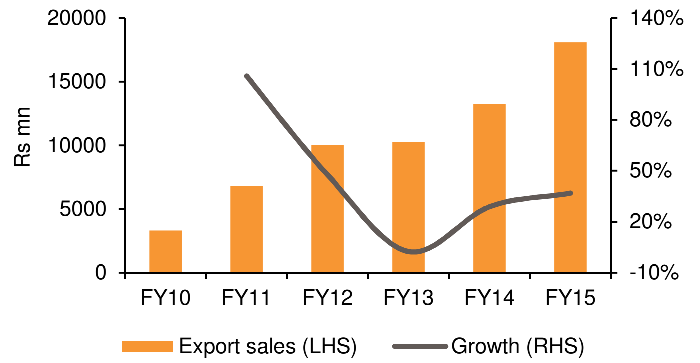
Source: Company, Emkay Research, Bloomberg

Exhibit 26: Export business assumptions

Assumptions	FY15	FY16E	FY17E	FY18E
Revenue	**18098**	**19523**	**19722**	**19671**
Revenue growth (%)	*36.8%*	*7.9%*	*1.0%*	*-0.3%*
EBITDA	**1424**	**1562**	**1562**	**1542**
EBITDA growth (%)	*-30.1%*	*9.7%*	*0.0%*	*-1.3%*
EBITDA margin (%)	*7.9%*	*8.0%*	*7.9%*	*7.8%*
PAT	**654**	**733**	**735**	**721**
PAT growth (%)	*-50.2%*	*12.0%*	*0.2%*	*-1.8%*
PAT margin (%)	*3.6%*	*3.8%*	*3.7%*	*3.7%*

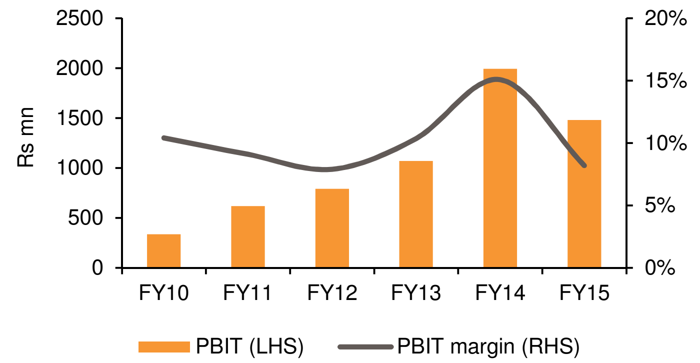
Source: Company, Emkay Research

Exhibit 27: Expect pace of growth to slow in exports



Source: Company, Emkay Research

Exhibit 28: Expect EBIT margins to sustain at 8%



Source: Company, Emkay Research

Receding regulatory hurdles - Relief for organised jewellers

- Various regulatory hurdles like the 80-20 rule and ban on 'gold on lease', which were imposed by the government in a bid to control gold imports, have now been lifted.
- This move comes as a relief to organised jewellers in the form of i) assured gold supplies and ii) improvement in operating and financial health due of re-instatement of 'gold on lease'.

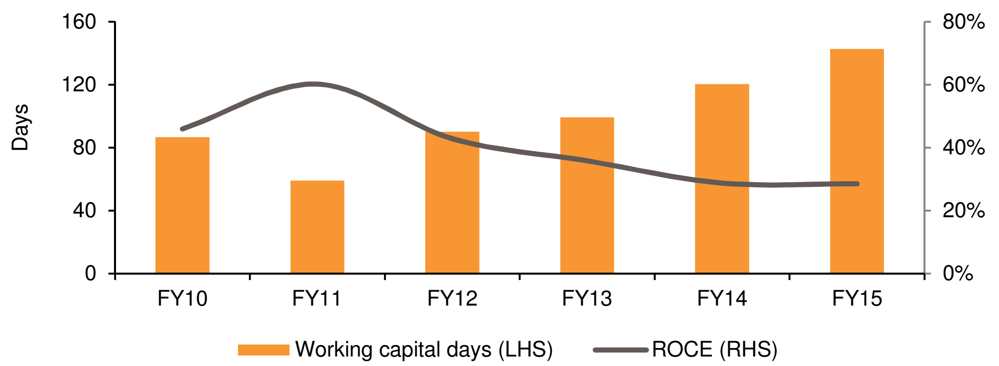
The jewellery industry, in the last 1-2 years, was crippled by regulatory headwinds. The government, to control rising gold imports and worsening current account deficit (CAD), imposed restrictions like introduction of 80:20 rule, abolishment of 'gold on lease' mechanism and sharp increase in gold import duties. All these restrictions had a material impact on the business operations of organised jewellers as they faced issues like supply shortage of gold and rise in balance sheet requirements due to abolition of 'gold on lease', which adversely impacted profitability, cash flows and return ratios.

The 80:20 rule did not have a material impact on PCJ as it had export operations and thus, supplies were assured. However, abolition of 'gold on lease' led to sharp spike in debt levels to Rs 10bn in FY14 and interest cost doubled in FY15 to Rs 2.2bn.

However, in the circular dated 28th November, 2014, RBI withdrew 80-20 rule and restrictions on import of gold. As a further clarification in this regard, in the circular dated 18th Feb, 2015, the RBI re-instated 'gold on lease' mechanism in full. At a time when the overall demand sentiments were benign, these were positive developments for the organised jewellers.

PCJ is a major beneficiary of this development, as about 70% of its domestic jewellery was gold jewellery and 100% of its gold requirement was through 'gold on lease', both for domestic as well as export operations. Reinstatement of 'gold on lease' mechanism was the biggest positive, as it eased business operations and improved balance sheet health (debt gets converted to current liability) and return ratios. The government has not yet started reducing the import duty, which we believe is imminent, as post scrapping of the 80:20 rule, gold premiums have shrunk, reducing arbitrage opportunities for illegitimate routes.

Exhibit 29: Working capital along with ROCE had deteriorated post abolition of 'gold on lease'



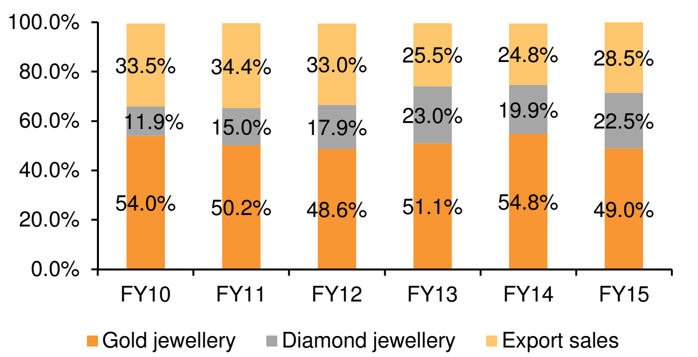
Source: Company, Emkay Research

Margin levers – Higher share of diamond jewellery & improving SSG

- PCJ's margin profile has improved, aided by rising share of domestic business in its overall sales and within its domestic revenue mix, increasing share of diamond jewellery. Diamond jewellery accounts for 23% of overall revenues and 32% of domestic revenues.
- Two triggers for margin uptick – Increasing share of diamond revenues and likely uptick in SSG. Expect 162 bps improvement in gross margins to 16.8% and 120 bps improvement in EBITDA margins to 12.6% by FY18.

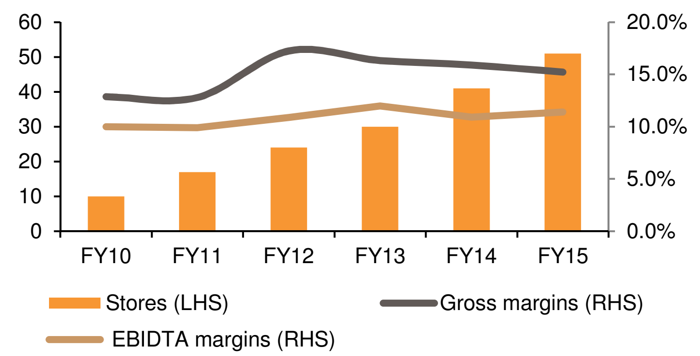
Despite being in an aggressive store expansion mode over the past few years, PCJ has managed to report gross & EBITDA margin improvement on the back on rising share of domestic business and within that, improving mix of diamond jewellery. Gross margins in gold jewellery are low at 9-10%, while that for diamond jewellery stands at 30-35%. Share of domestic revenues has improved from 66% in FY10 to 72% in FY15, while share of diamond jewellery has improved from 12% in FY10 to 23% in FY15. Subsequently, gross margin has improved by 243bps yoy to 15.2% and EBITDA margin has improved by 141bps to 11.4% in FY15.

Exhibit 30: Diamond mix continues to improve



Source: Company, Emkay Research

Exhibit 31: Maintained margins despite store expansion



Source: Company, Emkay Research

We have stated below the dynamics of a PCJ store (~5000 sq ft). Assuming diamond mix is 30%, the store can achieve 11-12% EBITDA margin. Given high gross margin profile of diamond jewellery, if the company expands its diamond share, there is further scope for margin expansion. However, it would come at higher inventory days as well, due to low turns in diamond jewellery.

Exhibit 32: PCJ store matrix

Rs mn	
Total sales	**600**
Gold sales (70%)	420
Diamond sales (30%)	180
Gross profit	**92**
Gold	38
Diamond	54
Gross Margins	**15.3%**
Gold margin	9.0%
Diamond margin	30.0%
Rentals	5
% of sales	*0.8%*
Employee costs	6
% of sales	*1.0%*
Advertisement costs	6
% of sales	*1.0%*
Other expenses	5
% of sales	*0.8%*
EBITDA	70
EBITDA margin	*11.7%*

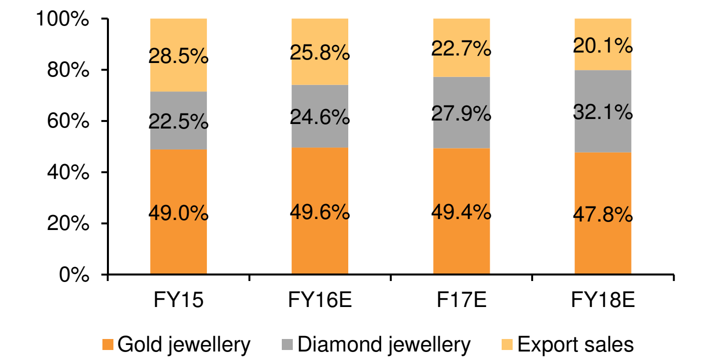
Source: Company, Emkay Research

We believe there are two key triggers for margin uptick in PCJ over the next few years

- Improving the product mix towards diamond jewellery, which will improve overall blended gross margins. Company is planning to increase its diamond jewellery share in the following ways: i) Increase ad spend outlay and aggressive promotion schemes/discounts to lure consumers towards diamond jewellery, ii) target college and working women population, with jewellery in lower/attractive price points and iii) product innovation like Flexia range (interchangeable diamond jewellery). We expect the share of diamond jewellery in domestic business to rise from 32% in FY15 to 40% by FY18.
- Revival in discretionary spending in metros and tier 1 and 2 cities, as well as growth in recently opened stores to drive SSG. If SSG growth exceeds cost inflation, it will trigger operating leverage, thereby driving margin expansion.

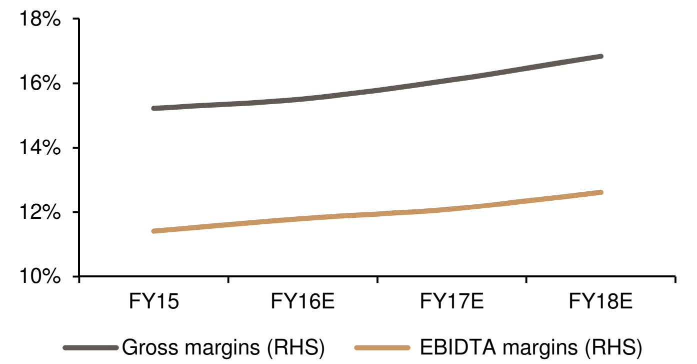
We expect 162 bps improvement in gross margins to 16.8% and 120 bps improvement in EBITDA margins to 12.6% by FY18.

Exhibit 33: Expect steady rise in share of diamond jewellery



Source: Company, Emkay Research

Exhibit 34: Margins to expand with rising diamond mix



Source: Company, Emkay Research

Downside risks to our margin assumption thesis are i) Sustained weak demand trends in jewellery, impacting SSG growth, ii) Higher than expected marketing and advertisement spends, but not resulting in uptick in diamond share and iii) higher than expected operational costs related to franchise model.

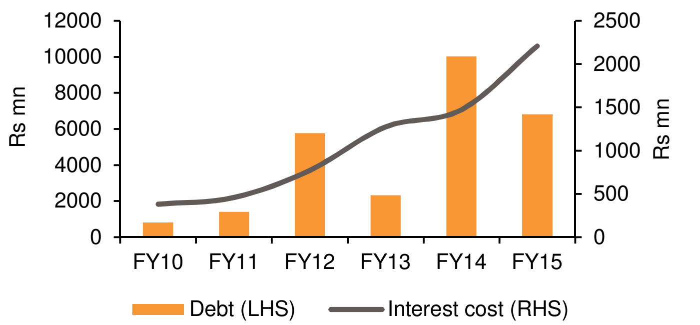
Balance Sheet & return ratios slated to improve

- Balance sheet concerns had accentuated in the last 12-18 months, post import restrictions, ban on gold on lease and introduction of 80:20 rule. This resulted in sharp rise in debt and strain on working capital.
- With import restrictions removed and 'gold on lease' back in the fray, terms of trade have become favourable with better working capital and debt reduction underway.
- Company is curtailing high receivables in export by reducing focus on exports business, while high inventory in domestic business is likely to be curtailed through venture into franchisee model. We expect net working capital to reduce from 142 days in FY15 to 127 days in FY18. We expect cash flow generation of Rs 3bn to be utilised for debt reduction.

Gold import restrictions by the government had severely impacted balance sheets of organised jewellers like Titan, PCJ, TBZ, etc. With the ban on 'gold on lease', most jewellery companies had to resort to purchasing gold against upfront cash, thus resulting in significant debt addition and subsequently, higher interest outgo. Moreover, as they were carrying risk of gold prices, they had to hedge their positions, thereby making this process far more tedious than 'gold on lease'. It also impacted the working capital cycle as creditor days were reduced substantially.

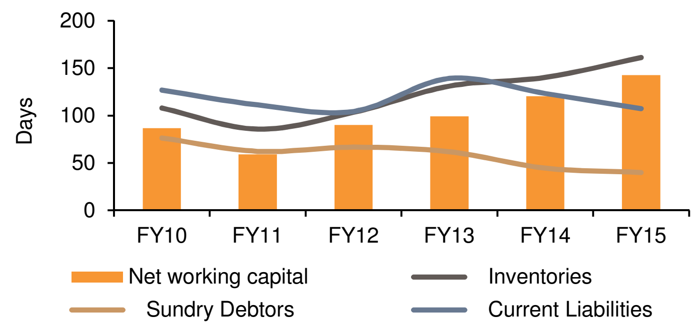
For PCJ, debt ballooned from Rs 2.3bn in FY13 to Rs 10bn in FY14. Interest cost rose sharply from Rs 1.3bn in FY13 to Rs 2.2bn in FY15. Further, creditor days declined from 139 days in FY13 to 108 days in FY15, while inventory days increased from 131 days in FY13 to 161 days in FY15. Historically, working capital days have been higher for PCJ due to gold jewellery exports, which have a high receivable cycle.

Exhibit 35: Sharp rise seen in debt and interest cost



Source: Company, Emkay Research

Exhibit 36: PCJ Net working capital was also on the rise



Source: Company, Emkay Research

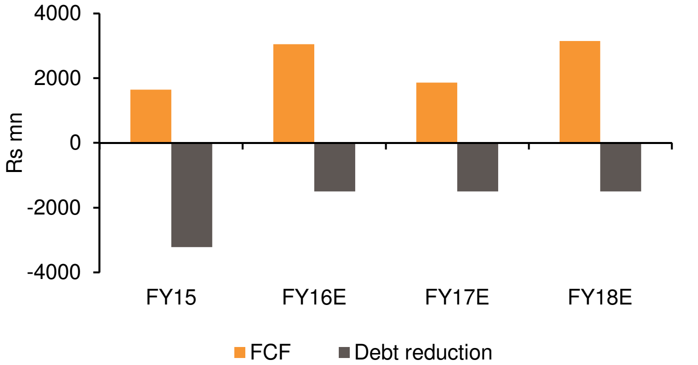
Post the abolition of import restrictions by the government, terms of trade have improved for organised jewellers as 'gold on lease' model is back, thereby reducing their debt on books and subsequently, interest liability. Post the abolition, the debt has moderated to Rs 6.8bn in FY15 and we believe despite aggressive store addition plans over the next 3-5 years, the company will reduce its debt liabilities using the free cash flows generated over the next 2-3 years.

To curtail the high receivable days in export business and high inventory days in domestic business, the company has strategized a two pronged approach:

- **Reduce concentration of export business:** Due to its B2B nature and high receivable cycle, the company is gradually reducing its focus and limiting client addition in the export segment.
- **Curtail inventory cycle via franchise route expansion:** While the company expects to add 100,000 square feet per year (about 100 stores) over the next five years, it also plans to expand its presence through the franchise route by opening ~200 franchises over the same period. We believe, as the franchisee model scales up, it will reduce the inventory cycle for PCJ and subsequently, improve return ratios for the company. **However, we have not factored any decline in working capital cycle or revenue addition due to introduction of franchisee model.**

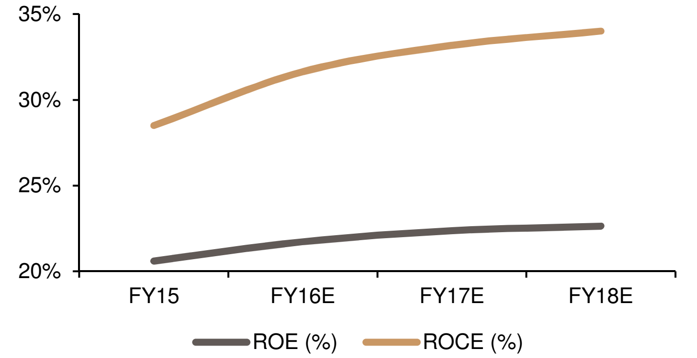
Reduced focus on export segment should lead to lower net working capital from 142 days in FY15 to 127 days in FY18. Even after assuming capex of Rs 500-600mn p.a. for the next 3 years, cash flow generation will be strong at Rs 3bn for FY18. Subsequently, we expect debt to reduce from Rs 7bn in FY15 to Rs 2bn in FY18. All this should aid in improved return ratios with ROCE at 34.5% and ROE at 23% by FY18.

Exhibit 37: FCF improvement and debt reduction expected



Source: Company, Emkay Research

Exhibit 38: Return ratios set to improve



Source: Company, Emkay Research

Valuation

Domestic segment is the key catalyst

We believe there are several growth triggers for the domestic business and we expect this segment to be the key catalyst for PCJ over the next few years. We expect domestic business to grow at 20% CAGR over the next 3 years led by aggressive store expansion, likely uptick in demand sentiments and innovation-led growth. Rising share of diamond jewellery and SSG uptick should drive margin profile. Further, we expect lifting of regulatory hurdles to result in lower debt and subsequently, lower interest cost, aiding profit growth. We expect 21% EBITDA growth and 29% PAT CAGR for the domestic business over FY15-18E.

Reducing focus & increasing disclosures in export segment aimed at allaying investor concerns

Company is gradually reducing its focus on export business, given limited export opportunities, low margin and high working capital requirements. Further, to allay investor concerns on the export segment, the company has gradually increased disclosures in this segment. We believe these efforts should reduce the investor wariness in this segment. Moreover, we expect investor focus to gradually shift to the improving growth profile of the domestic business, thereby improving overall valuations.

Value company on SOTP basis; Initiate with BUY and target price of Rs 490/share

Given the growth & margin profile of both the businesses, we have separately valued the domestic segment and the export segment. We have valued the domestic segment using the PE valuation methodology, assigning a 40% discount to Titan's P/E multiple (Titan has a superior parentage & well-established national brand). We believe rising significance of domestic business and reducing focus on export business for PCJ should gradually narrow valuation gap between Titan & PCJ. The current valuation gap between Titan & PCJ is 60% on FY17 earnings estimates. We value the export business on a PE basis, assigning it in line with Rajesh Exports (FY15 trailing P/E is 10.8x). Based on our SoTP valuation, our target price works out to Rs 490 per share. We initiate coverage on PCJ with a BUY recommendation and price target of Rs 490 per share.

Exhibit 39: SoTP valuation table

Segment	FY17 PAT	P/E multiple	Value	Reason
Domestic business	5233	16	83733	Assigned 40% discount to Titan multiples
Export business	735	5	3673	In-line with other listed entity
Market Cap (Rs mn)			87406	
Shares outstanding(mn)			179	
Per share value			**490**	
CMP			367	
% upside from CMP			*33.2%*	

Source: Company

Peer Comparison

For the domestic segment, we have compared PCJ with other organised jewellers and few retail & discretionary businesses. For the export segment, we have drawn comparison with other jewellery exporters like Rajesh Exports. We have also drawn comparison to large global jewellery retailers.

Exhibit 40: Peer valuation

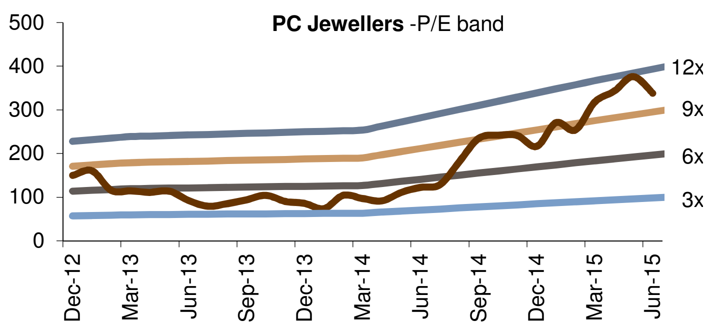
	Sales		EBITDAM (%)	PAT		PE	EV/EBITDA	P/B	ROCE (%)
Company	**FY17E**	**CAGR FY15-17E**	**FY17E**	**FY17E**	**CAGR FY15-17E**	**2017E**	**2017E**	**2017E**	**2017E**
Gems and Jewellery									
PC JEWELLER	86754	17%	12.1%	5968	26%	11.0	6.3	2.2	33.2%
RAJESH EXPORTS *	NA	NA	NA	NA	NA	10.8	3.8	2.1	NA
TBZ	37895	40.0%	7.6%	1555	145%	6.2	5.2	12.8	NA
TITAN (Bloomberg estimates)	162365	17%	10.0%	11942	21%	26.5	19.5	6.8	52.4%
TITAN (Emkay estimates)	168029	19%	10.5%	13324	33%	23.8	17.3	6.7	39.5%

	Sales		EBITDAM (%)	PAT		PE	EV/EBITDA	P/B	ROCE (%)
Company	**FY17E**	**CAGR FY15-17E**	**FY17E**	**FY17E**	**CAGR FY15-17E**	**2017E**	**2017E**	**2017E**	**2017E**
Discretionary retail									
BATA INDIA	26151	12.5%	14.3%	2281	9.3%	29.5	17.4	5.8	37.6%
JUBILANT FOODWORKS	34306	28.0%	15.2%	2555	51.7%	46.8	22.7	11.6	59.8%
SHOPPERS STOP	54530	15.8%	6.2%	968	51.1%	34.0	11.7	5.3	42.0%

	Sales		EBITDAM (%)	PAT		PE	EV/EBITDA	P/B	ROCE (%)
Company	**FY17E**	**CAGR FY15-17E**	**FY17E**	**FY17E**	**CAGR FY15-17E**	**2017E**	**2017E**	**2017E**	**2017E**
Foreign discretionary retail									
CHRISTIAN DIOR	37798	10.5%	23.9%	1928	16.3%	17.8	6.2	2.6	43.9%
HERMES INTERNATIONAL	5393	14.4%	36.0%	1174	16.9%	32.2	18.8	8.3	57.8%
LOUIS VUITTON	37738	11.0%	24.0%	4454	-11.2%	19.4	10.3	3.1	45.3%
SIGNET JEWELERS	6852	9.3%	16.1%	632	28.7%	16.6	10.8	3.0	23.9%
TIFFANY & CO	4620	4.3%	26.2%	616	12.8%	19.5	10.3	3.6	25.4%

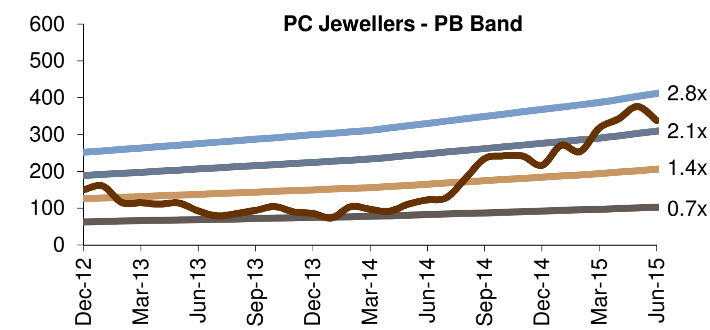
Source: Company, Bloomberg, Emkay Research
** Valuation on TTM basis*

Exhibit 41: PE chart; company has traded between 3x-12x



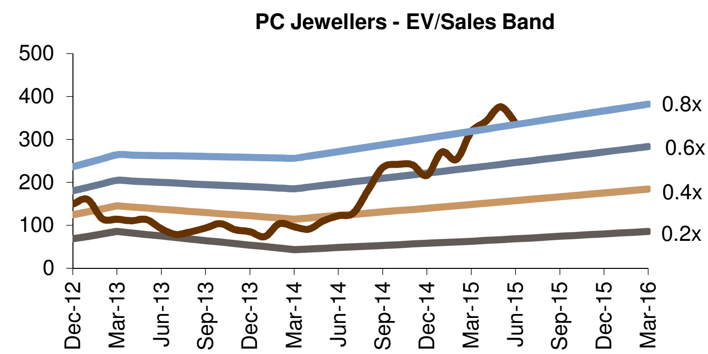
Source: Emkay Research, Bloomberg

Exhibit 42: PB chart; company has traded between 0.7x-2.8x



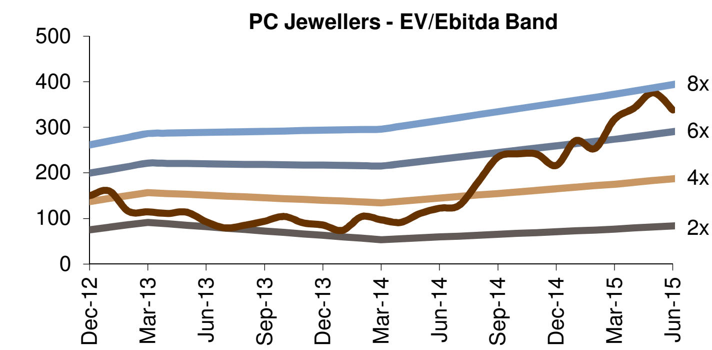
Source: Emkay Research, Bloomberg

Exhibit 43: EV/sales chart; company has traded between 0.2x-0.8x



Source: Emkay Research, Bloomberg

Exhibit 44: EV/EBITDA chart; company has traded between 2x-8x



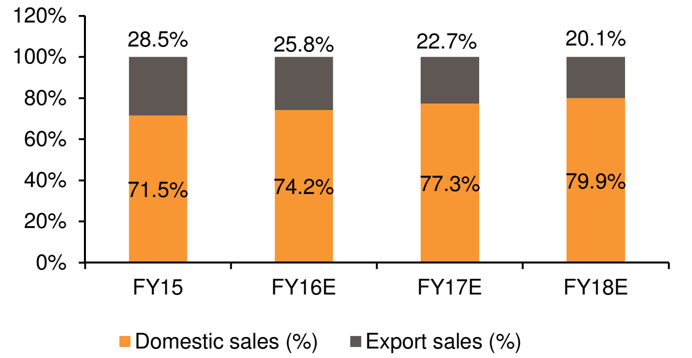
Source: Emkay Research, Bloomberg

Financials

Domestic business to drive revenue growth of 15.5% CAGR over FY15-18E

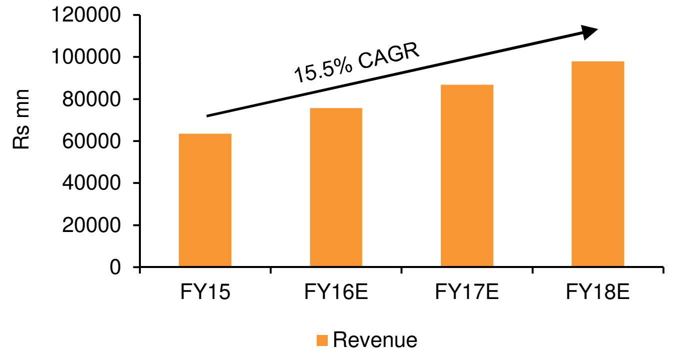
We believe domestic business is the key growth driver for PCJ and expect it to grow at 20% CAGR, with gold and diamond businesses expected to grow at a CAGR of 14.6% and 30% respectively over FY15-18E. With a cautious approach towards the B2B business, we expect growth in the export business to be tepid at 2.8% CAGR over FY15-18E. We expect the increasing share of revenues from the domestic business to drive the overall revenue growth by 15.5% CAGR over FY15-18E to Rs 98bn.

Exhibit 45: Increasing share of domestic revenues…



Source: Company, Emkay Research

Exhibit 46: ...to drive 15.5% revenue CAGR over FY15-18E

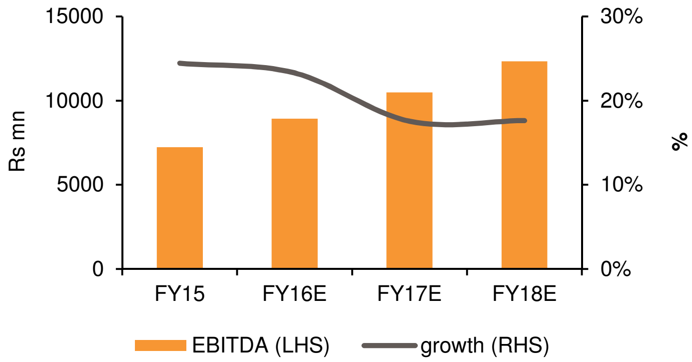


Source: Company, Emkay Research

SSG uptick and mix improvement to drive margin uptick

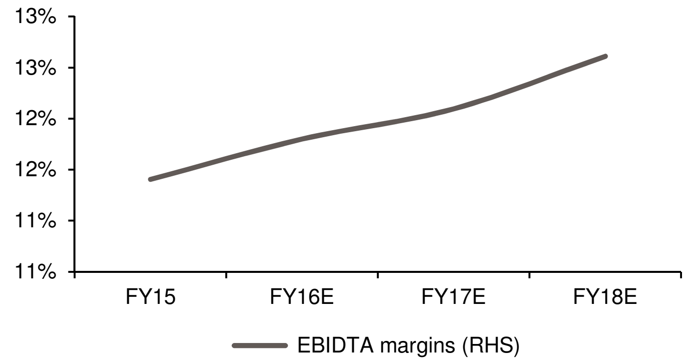
We expect PCJ's EBITDA margins to improve by 121 bps over FY15-18E, on the back of the following factors: i) Revival in urban consumption will drive SSG growth, thereby driving operating leverage ii) PCJ is constantly improving its product mix in favour of high margin diamond products; we expect mix improvement in favour of diamond to continue. We expect standalone EBITDA to grow at 20% CAGR to Rs 12.3bn and margins to improve to 12.6%, up 120 bps over FY15-18E

Exhibit 47: EBITDA to grow at a CAGR of 20%



Source: Company, Emkay Research

Exhibit 48: EBITDA margins to improve by 120 bps to 12.6% by FY18

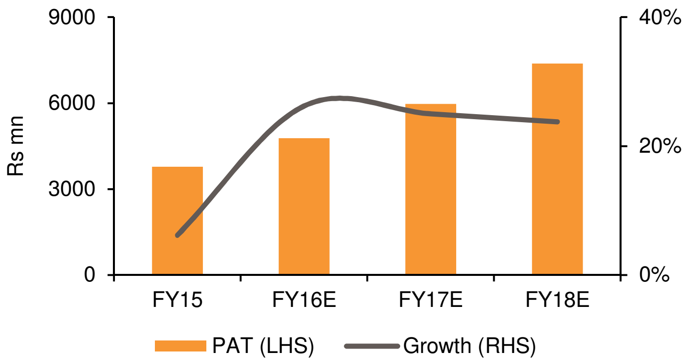


Source: Company, Emkay Research

Reduced interest to drive PAT growth

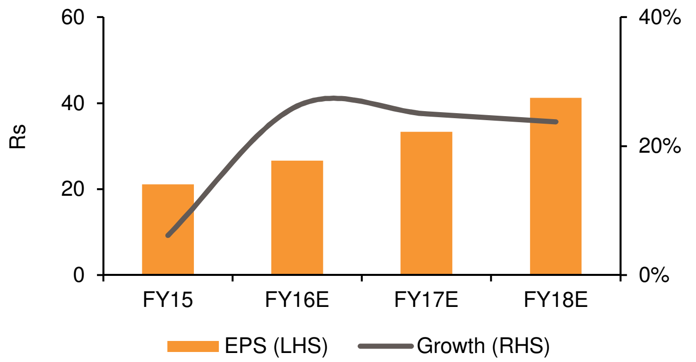
Increasing EBITDA coupled with a reduction in debt, post the reinstatement of gold on lease mechanism, will reduce interest costs. We expect PAT to grow by 25% CAGR to Rs 7.4bn and EPS to grow at 25% to Rs 41.2 over FY15-18E.

Exhibit 49: PAT expected to grow at 25% CAGR



Source: Company, Emkay Research

Exhibit 50: Expect EPS to rise to Rs 41.2/share

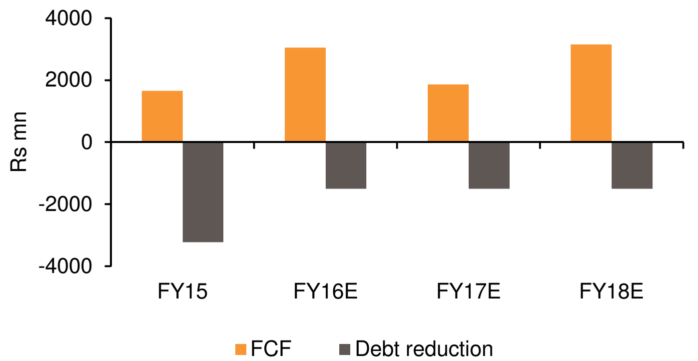


Source: Company, Emkay Research

Operating leverage and reduction in working capital to drive profitability, free cash flows and return ratios

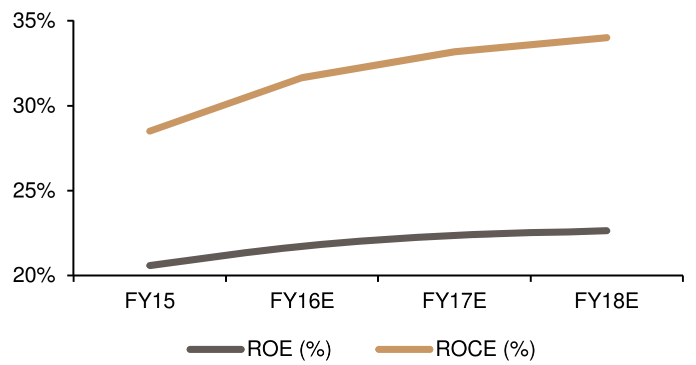
Operating leverage and mix improvement should drive margin profile; in addition, lower interest outgo will further aid profit growth. Reduced focus on high debtors days export segment would further result in improved free cash flows. We expect PAT and free cash flow to grow at 25% and 24% CAGR over FY15-18E respectively. With improving profitability and controlled working capital, we expect the ROCE to expand by 590 bps to 34.5% in FY18E.

Exhibit 51: FCF improvement and debt reduction expected



Source: Company, Emkay Research

Exhibit 52: Return ratios set to expand



Source: Company, Emkay Research

Risks

Resurfacing of regulatory action by the government to curtail gold consumption, sustained weakness in gold demand, franchise model failing to take off as expected, rising competition among the organised players and emergence of e-commerce as an alternate channel are key risks for PCJ.

Regulatory risk with PAN card

The government, in its latest finance bill, has proposed to make PAN card mandatory for gold purchases above the amount of Rs 100,000. This move could potentially impact the sales of gold for the following reasons- i) Lack of PAN cards in semi-urban & rural India ii) Purchases by members of the family, such as housewives who do not have PAN cards and iii) Privacy related issues.

Sustained weak gold demand may hamper growth; Also, weak gold prices may result in lower investment interest

Weak gold prices, muted discretionary demand sentiments and regulatory hurdles had impacted growth of organised jewellers in the last few quarters. While we believe sentiments are likely to have bottomed out, any prolonged weakness in sentiments could dent growth outlook and expansion strategy of organised jewellers. Negative absolute returns in gold for last 1-2 years may result in investors moving to other asset classes. Increasing financial awareness and knowledge coupled with government run programmes such as gold monetising plans could have a negative impact on gold sales. However, given the insatiable demand for gold in the country and limited means of investment opportunities, especially in tier 2/3 cities and rural India, we expect long term demand for gold to remain healthy.

Failure of franchisee model poses a threat to business operations

PCJ is planning to expand its presence in smaller towns using the franchisee model. Though it's an asset light model and will have a positive impact on return ratios, any adverse fallout from the franchise stores could impact business operations and financials.

Threat and Opportunity from e-commerce

E-commerce in India has been growing rapidly over the past few years, especially in tier I/II cities eating into the share of organised retail. While it is still at a nascent stage in the gems and jewellery segment, we cannot rule out a similar growth. However, PCJ has been very proactive with their own e-commerce portal WearYourShine.com and we believe, they are well equipped not only to tackle the threat, but also use e-commerce to boost their own revenues.

Rising competition in organised sector

PCJ faces competition from various national and domestic players in the organised space. However, many large competitors are based in South India and have a very different target audience due to the nature of the product (largely gold jewellery based). While there is risk from competition, we believe that in future, the company will be largely insulated from such competition owing to PCJ's focus on diamond/studded jewellery.

Unorganised sector still large

While the recent industry trend has witnessed a shift towards the organised sector, the unorganised players still constitute ~80% of the total industry. Moreover, tightening by the regulators could lead to consumers shifting back to unorganised players, so as to refrain from disclosing their PAN details.

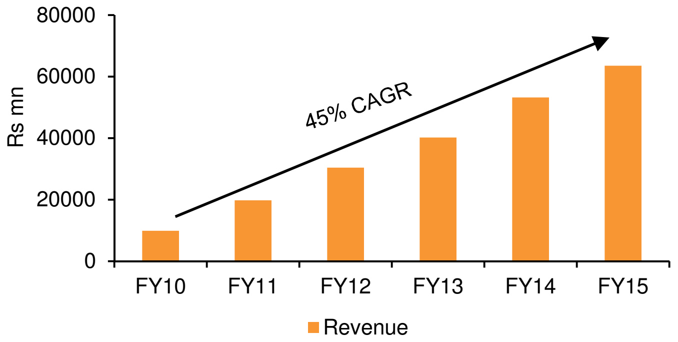
Company background

History

PC Jeweller (PCJ) has been present in the form of PP Jewellers since 1981. PP Jewellers were involved in wholesale as well as export businesses. They were one of the first companies to get permission from RBI to avail the 'gold on lease' programme. But, due to differences in long term vision (regarding store expansion), the current promoters of PC Jewellers split and created their own brand in 2005.

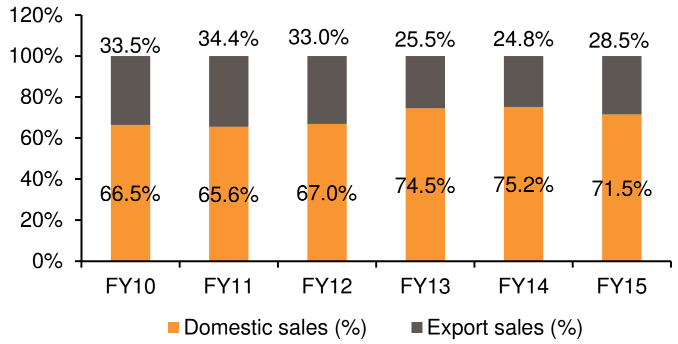
The company was incorporated in 2005 under the name, P Chand Jewellers Private Limited and was renamed to PC Jewellers Private Limited in 2009. They opened their first store in Karol Bagh, New Delhi in 2005 and have since expanded to 51 stores across 42 cities and 17 states.

Exhibit 53: Revenue growth – FY10-15 CAGR of 45%



Source: Company, Emkay Research

Exhibit 54: Sales break-up – Share of domestic sales growing



Source: Company, Emkay Research

Management biography

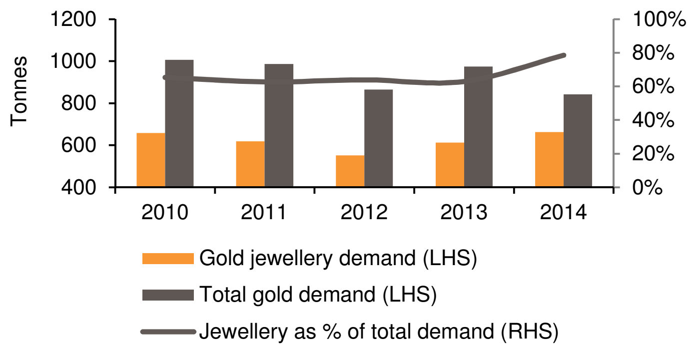
- Mr. Padam Chand Gupta, Chairman: He has over 20 years of experience in the jewellery industry and has been involved with the company since inception
- Mr. Balram Garg, Managing Director: He too has been involved with the company since incorporation and has over 20 years of experience in the jewellery business. He holds a bachelor's degree in commerce from the University of Delhi
- Mr. Manohar Lal Singla, Independent Director: He is currently the professor of management at Faculty of Management Studies, University of Delhi and has over 25 years' experience in academics
- Mr. Krishan Kumar Khurana, Independent Director: He has over 25 years' experience in the legal service industry and is a practising advocate of the Supreme Court of India and High Court of New Delhi

Appendix

Gems and Jewellery industry

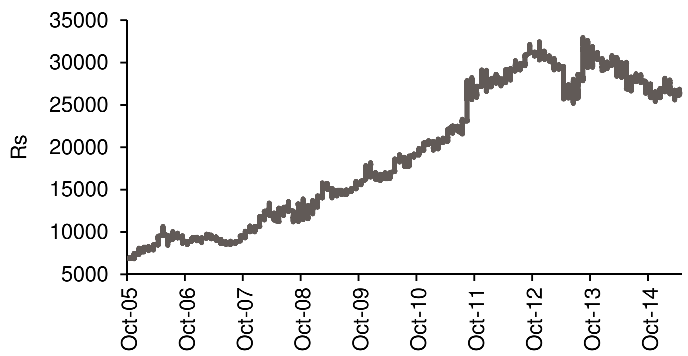
The total size of the Indian gems and jewellery industry is estimated to be ~Rs 3tn and has been growing at a CAGR of 16% over FY09-FY14. However, organised jewellery market is just 22% of the overall market, with national players being just 5%. As per industry reports, the gems and jewellery industry is expected to grow at 16% CAGR over the next three years to reach the size of Rs 5.4tn. However, as per industry estimates, the organised market is likely to grow at a faster clip, led by industry growth and market share gains from unorganised players. The share of organised jewellery is expected to reach 35% in the next few years.

Exhibit 55: Jewellery as % of total demand rising



Source: Industry, World Gold Council, Emkay Research

Exhibit 56: Gold prices (Rs/10gm) – has fallen 12-15% from the peak



Source: Bloomberg, Emkay Research

It is estimated that gold sales contribute to ~80% of the total gems and jewellery market. Gold is purchased in India, both as jewellery and as an investment. Over the past five years, the average gold demand in the country has been 935 tonnes.

Multiple growth drivers in the jewellery industry

Shift from unorganised to organised

The biggest driver in this industry is the shift from unorganised to organised/branded players. It is estimated that organised market is ~Rs 660 bn and as per industry reports, it is expected to grow at a CAGR of 30% over the next four years to Rs 1.9tn. The growth rate of the organised market is nearly double that of the industry. Therefore, the organised players are likely to sustain this growth momentum over the next four to five years.

Favourable demographics

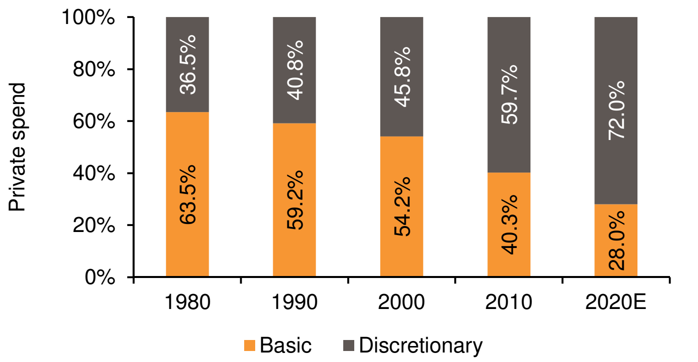
India's strong demographic profile is one of the key drivers for sustained growth in organised formats. Factors like rise in disposable income, increasing urbanisation, changing lifestyle with greater exposure to global fashion/tastes and rise in discretionary spends have been pivotal factors for healthy growth of organised sector.

Income - The urban population, which accounted for 30% of total population in 2010, is expected to rise to 40% in 2030. Thus, rapidly rising household incomes, coupled with urbanization of Indian population will lead to jump in overall consumer spending.

Aspiration - Branded jewellery has an aspirational value for the evolving Indian consumer. Further, the rise of organized retail has led to faster proliferation and distribution of branded jewellery, providing convenience of trade for branded jewellery.

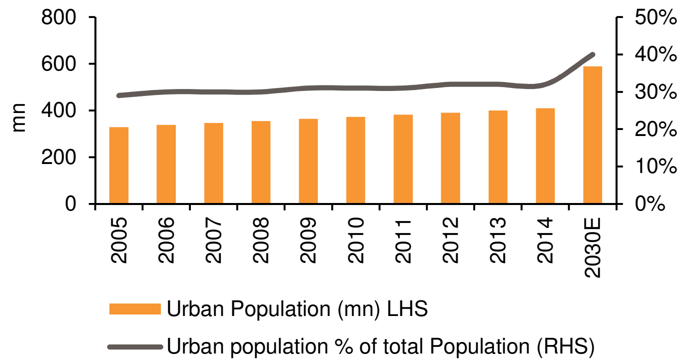
Consumption – The penetration of branded jewellery is abysmally low as this market is largely dominated by un-organised players. But, branded jewellery is gaining importance as consumption pattern is changing towards aspirational products and brand association

Exhibit 57: Growing share of discretionary spending



Source: Trading Economics, World Bank, Emkay Research

Exhibit 58: India urban shift



Source: World Bank, UN, Emkay Research

Focus on quality

In Tier 2/3 cities, gold's quality and purity remains a critical issue. Therefore, there has been a growing focus towards the quality of the product with hallmarking and certification. The organised players in this sector provide assurance in quality and purity with such certifications, and therefore, there has been a growing shift to branded jewellery. To enhance customer faith, many organised players provide a buy-back guarantee on diamonds. All these efforts are aimed at gaining customer trust and switch them to organised jewellery formats.

Most regulatory headwinds are behind us

80:20 rule

To control rising gold imports and worsening current account deficit (CAD), the government introduced the 80:20 scheme, wherein 20% of imported gold was required to be exported. However, in the circular dated 28th November, 2014, RBI withdrew the 80-20 rule and restrictions on import of gold.

Gold on Lease

Additionally, to counter rising CAD, the RBI abolished the 'gold on lease' scheme in August 2013. The 'gold on lease' facility allows a jeweller to lease gold from the supplier for a specified period, thereby reducing inventory risk. As the gold spot price is set at the end of the lease period, this scheme also acts as a natural hedge from any gold price fluctuation. In the circular dated 18th Feb, 2015, the RBI re-instated 'gold on lease' mechanism in full.

Gold import duty

Between January 2012 and August 2013, the gold import duty was raised from 2% to 10%. Post lifting of regulatory hurdles by the government, market participants expected reduction on gold imports in the 2015 budget, but the government maintained the import duty at the current level. With withdrawal of 20-80 rule, we don't see the need to keep gold import duty. Any cut in import duty would improve the competitiveness of organized jewellers and foster market share gains.

Key Financials (Standalone)

Income Statement

Y/E Mar (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Net Sales	**53,248**	**63,485**	**75,655**	**86,754**	**97,891**
Expenditure	**47,431**	**56,245**	**66,728**	**76,260**	**85,545**
EBITDA	**5,817**	**7,240**	**8,927**	**10,494**	**12,345**
Depreciation	123	230	310	394	484
EBIT	**5,694**	**7,010**	**8,617**	**10,100**	**11,862**
Other Income	472	592	216	226	238
Interest expenses	1,473	2,209	2,025	1,816	1,566
PBT	**4,694**	**5,393**	**6,807**	**8,510**	**10,533**
Tax	1,131	1,611	2,033	2,542	3,146
Extraordinary Items	0	0	0	0	0
Minority Int./Income from Assoc.	0	0	0	0	0
Reported Net Income	**3,563**	**3,782**	**4,774**	**5,968**	**7,387**
Adjusted PAT	**3,563**	**3,782**	**4,774**	**5,968**	**7,387**

Balance Sheet

Y/E Mar (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
Equity share capital	1,791	1,791	1,791	1,791	1,791
Reserves & surplus	15,032	18,113	22,171	27,243	33,511
Net worth	**16,823**	**19,904**	**23,962**	**29,034**	**35,302**
Minority Interest	**0**	**0**	**0**	**0**	**0**
Loan Funds	**10,034**	**6,814**	**5,314**	**3,814**	**2,314**
Net deferred tax liability	(107)	(125)	(125)	(125)	(125)
Total Liabilities	**26,749**	**26,592**	**29,150**	**32,723**	**37,490**
Net block	**839**	**896**	**1,093**	**1,235**	**1,318**
Investment	**1,850**	**132**	**132**	**132**	**132**
Current Assets	**40,097**	**45,962**	**52,286**	**59,615**	**68,209**
Cash & bank balance	3,301	2,741	3,572	3,041	3,568
Other Current Assets	908	119	612	702	792
Current liabilities & Provision	**16,047**	**20,398**	**24,361**	**28,259**	**32,168**
Net current assets	**24,049**	**25,565**	**27,925**	**31,356**	**36,040**
Misc. exp	0	0	0	0	0
Total Assets	**26,749**	**26,592**	**29,150**	**32,723**	**37,490**

Cash Flow

Y/E Mar (Rs mn)	FY14	FY15	FY16E	FY17E	FY18E
PBT (Ex-Other income) (NI+Dep)	**4,221**	**4,801**	**6,592**	**8,283**	**10,296**
Other Non-Cash items	(1,037)	0	0	0	0
Chg in working cap	(12,362)	(2,093)	(1,530)	(3,962)	(4,157)
Operating Cashflow	**(9,044)**	**1,937**	**3,555**	**2,400**	**3,713**
Capital expenditure	(281)	(287)	(507)	(536)	(567)
Free Cash Flow	**(9,325)**	**1,650**	**3,047**	**1,864**	**3,146**
Investments	2,579	1,718	0	0	0
Other Investing Cash Flow	(595)	0	0	0	0
Investing Cashflow	**2,176**	**2,023**	**(292)**	**(310)**	**(329)**
Equity Capital Raised	0	0	0	0	0
Loans Taken / (Repaid)	7,713	(3,220)	(1,500)	(1,500)	(1,500)
Dividend paid (incl tax)	(524)	(573)	(716)	(896)	(1,119)
Other Financing Cash Flow	1,465	1,617	1,810	1,590	1,328
Financing Cashflow	**7,181**	**(4,385)**	**(2,432)**	**(2,622)**	**(2,857)**
Net chg in cash	**313**	**(425)**	**831**	**(531)**	**527**
Opening cash position	798	1,111	2,741	3,572	3,041
Closing cash position	**3,301**	**2,741**	**3,572**	**3,041**	**3,568**

Key Ratios

Profitability (%)	FY14	FY15	FY16E	FY17E	FY18E
EBITDA Margin	10.9	11.4	11.8	12.1	12.6
EBIT Margin	10.7	11.0	11.4	11.6	12.1
Effective Tax Rate	24.1	29.9	29.9	29.9	29.9
Net Margin	6.7	6.0	6.3	6.9	7.5
ROCE	28.7	28.5	31.7	33.4	34.5
ROE	23.2	20.6	21.8	22.5	23.0
RoIC	37.1	30.9	35.1	36.7	37.5

Per Share Data (Rs)	FY14	FY15	FY16E	FY17E	FY18E
EPS	19.9	21.1	26.7	33.3	41.2
CEPS	20.6	22.4	28.4	35.5	43.9
BVPS	93.9	111.1	133.8	162.1	197.1
DPS	2.9	3.2	4.0	5.0	6.3

Valuations (x)	FY14	FY15	FY16E	FY17E	FY18E
PER	18.4	17.4	13.8	11.0	8.9
P/CEPS	17.8	16.4	12.9	10.3	8.4
P/BV	3.9	3.3	2.7	2.3	1.9
EV / Sales	1.3	1.1	0.9	0.8	0.7
EV / EBITDA	12.1	9.6	7.5	6.3	5.2
Dividend Yield (%)	0.8	0.9	1.1	1.4	1.7

Gearing Ratio (x)	FY14	FY15	FY16E	FY17E	FY18E
Net Debt/ Equity	0.3	0.2	0.1	0.0	0.0
Net Debt/EBIDTA	0.8	0.5	0.2	0.1	(0.1)
Working Cap Cycle (days)	142.2	131.2	117.5	119.1	121.1

Growth (%)	FY14	FY15	FY16E	FY17E	FY18E
Revenue	32.5	19.2	19.2	14.7	12.8
EBITDA	20.7	24.5	23.3	17.6	17.6
EBIT	20.7	23.1	22.9	17.2	17.4
PAT	22.6	6.2	26.2	25.0	23.8

Quarterly (Rs mn)	Q4FY14	Q1FY15	Q2FY15	Q3FY15	Q4FY15
Revenue	15,361	13,230	11,836	18,217	20,202
EBITDA	1,598	1,476	1,705	2,038	2,066
EBITDA Margin (%)	**10.4**	**11.2**	**14.4**	**11.2**	**10.2**
PAT	836	696	792	1,093	1,201
EPS (Rs)	**4.7**	**3.9**	**4.4**	**6.1**	**6.7**

Shareholding Pattern (%)	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Promoters	70.6	70.6	70.6	70.6	70.6
FIIs	13.0	11.2	13.4	13.0	17.7
DIIs	3.0	2.9	2.4	2.4	0.2
Public and Others	13.4	15.4	13.7	14.1	11.6

Emkay Rating Distribution

BUY	Expected total return (%) (Stock price appreciation and dividend yield) of over 25% within the next 12-18 months.
ACCUMULATE	Expected total return (%) (Stock price appreciation and dividend yield) of over 10% within the next 12-18 months.
HOLD	Expected total return (%) (Stock price appreciation and dividend yield) of upto 10% within the next 12-18 months.
REDUCE	Expected total return (%) (Stock price depreciation) of upto (-) 10% within the next 12-18 months.
SELL	The stock is believed to underperform the broad market indices or its related universe within the next 12-18 months.

Emkay Global Financial Services Ltd.
CIN - L67120MH1995PLC084899
7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India
Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com