PC JEWELLER IS ONE OF THE MOST EFFICIENT MODERN JEWELRY RETAILERS WITH A STRONG GROWTH OUTLOOK, A HEALTHY BALANCE SHEET, A CHEAP VALUATION AND INSIDER BUYING

PC Jeweller	**5/25/2014**
Ticker: BSE: 534809 | NSE: PCJEWELLER	Price: ₹123.25
Rating: Buy	Position Size: 10%
FY2015 No Growth Price Target: ₹226.96	FY2015 5% Growth Price Target: ₹277.59

INVESTMENT THESIS

PC Jeweller is a leading Indian jewelry retailer with 41 showrooms across India. It is strong operator consistently generating above average margins, IC Turnover and Return on Invested Capital. The company is managed by owner operators with a long-term outlook and incentives aligned with minority shareholders by virtue of owning over 70% of the company and total compensation less than 1.5% of operating income. The company will more than double its showroom over the next five years and has a very strong financial position with net debt to EV of 18%. Despite the company's strengths, it is trading on a pre-tax operating income yield of 20% twice the local AAA corporate bond yield. It warrants a 10% position.

KEYS TO EVALUATING A BUSINESS

1. The certainty with which the long-term economic characteristics of the business can be evaluated

The Indian Jewelry industry does not seem to have any barriers to entry given there are 4,500 jewelry retailers in the industry. Most of these competitors are traditional retailers. Modern retailers only account for about 20% of the total jewelry market in India but increasing their share. Although barriers to entry seem not to exist, PC Jeweller consistently generates ROIC significantly above its cost of capital and its competitors. This can be attributed to the strength of PC Jeweller's designs, its focus on the wedding segment, its strength in selling diamonds and weak competition from the traditional sector.

PC Jeweller is not exposed to gold price fluctuations as the company purchases inventory through gold leasing programs allowing the company to price the inventory at the time of sale, assuming it is within 180 days.

PC Jeweller's earnings power should improve over time given the growth expected in the market, PC Jeweller's growth in the number of showrooms, and the low penetration of the modern market.

2. The certainty with which management can be evaluated, both as to its ability to realize the full potential of the business and to wisely employ its cash flows

Management has not allocated capital to anything other than store expansion, and a small cash dividend. This and management's statements of future expansion provide evidence that the company will continue to allocate capital to showroom expansion. The company is a strong operator generating ROIC well above the industry average. As owner operators whose wealth is derived primarily from PC Jeweller, management ensures the company maintains a healthy financial position. The company continued expansion will be financed by cash flows and gold leasing programs for inventory requirements. Both ensure PC Jeweller will stay financially strong.

3. The certainty with which management can be counted on to channel the rewards from the business to the shareholders rather than to itself

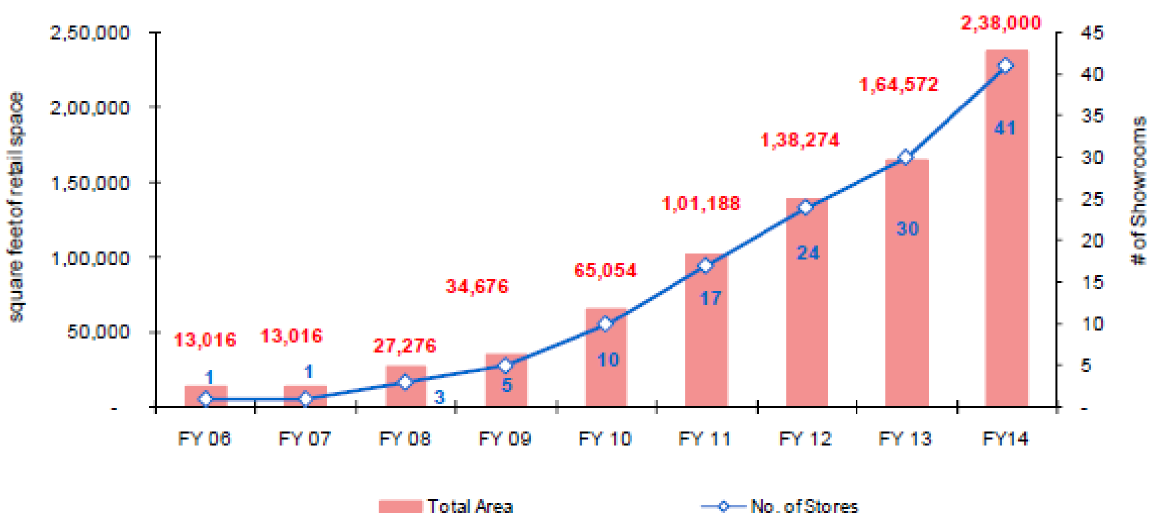
There are no corporate governance issues, management owns 70% of the company's shares and management has started paying a small dividend. Management's wealth is directly tied to share ownership, as management's base salary is less than a percent of the value of the shares outstanding, ensuring incentives are aligned with minority shareholders. The small dividend paid would be better allocated to expansion and brand building in new regions, but it seems to be a signal of management's intention to pay dividends in the future as the business matures.

4. The purchase price of the business

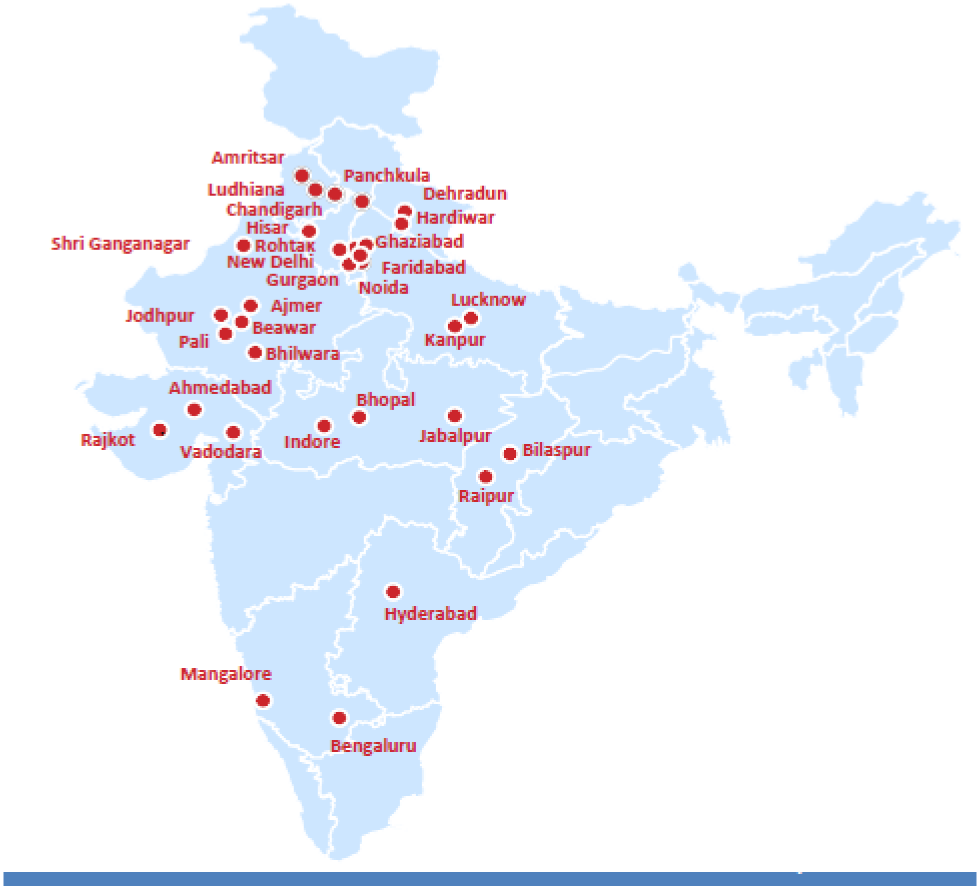
A period of regulatory pressure created an environment where growth slowed, upfront investment requirements increased, and demand weakened due to cyclicality leading to weak share prices within the sector. PC Jeweller is trading at a 20% EBIT yield almost twice the AAA corporate bond yield. This yield is extremely attractive given the growth outlook for the industry and company. The company is also trading well below peers despite stronger returns, financial health and corporate governance.

COMPANY DESCRIPTION

PC Jeweller started operations in April 2005 with one showroom at Karol Bagh Delhi. It is a first generation business promoted by two brothers, Padam Chand Gupta and Balram Garg. Mr. Padam Chand Gupta, Chairman of the company has three decades of jewelry experience. At the end of FY2014 (March 31, 2014), PC Jeweller had 41 showrooms with 238,000 total square feet. PC Jeweller is targeting 56 showrooms with 338,000 total square feet by the end of FY2015. PC Jeweller has yet to close any of its showrooms.



PC Jeweller has its origins in Delhi NCR. It built operations and showrooms in the region and has expanded to other regions within India. With showrooms in Tier I, Tier II and metros, the company is disciplined to wait for locations on high streets.

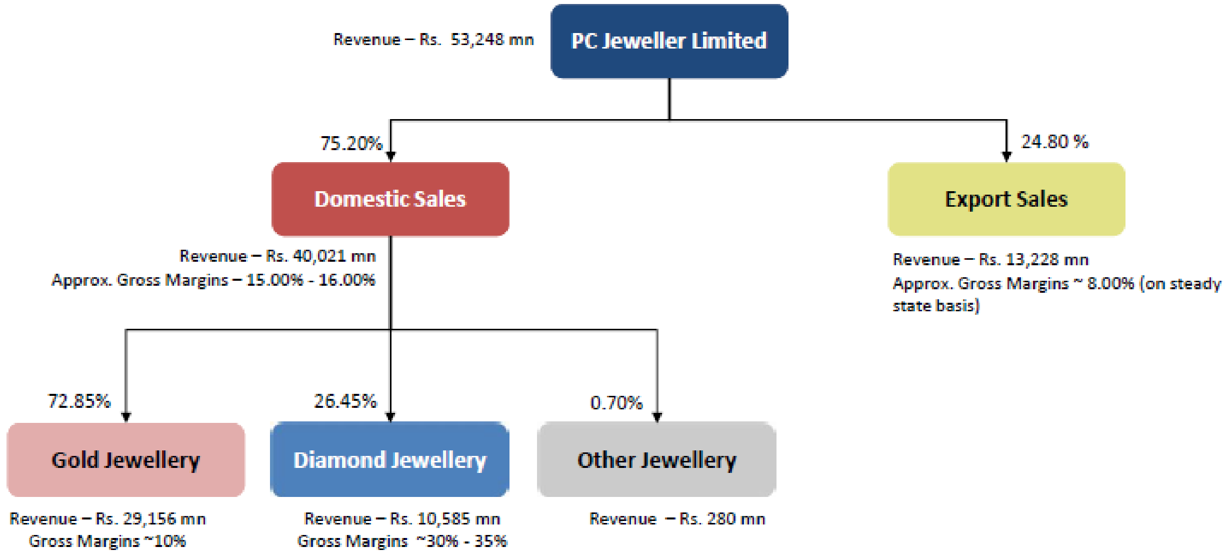


*As on 22 May 2014,; All showrooms, except Chandigarh showroom, are directly managed

The company's business model consists of opening large format, stand-alone stores at high street locations. Its stores stock a wide range of jewelry across all price points, with an increasing focus on diamond jewelry. The company sells only hallmarked jewelry and certified diamond jewelry. This assurance on quality & purity along with transparent & customer friendly policies has enabled PC Jeweller to become an established and trusted brand name in a short time span.

The managers of PC Jeweller are owner operators. At the end of FY2014, the promoters hold 70.55% of total shares outstanding up from 70.02% from the end of FQ3 2014. No shares are pledged.

The company has two business segments: domestic and export. The domestic division accounts for roughly 75% of sales and the export division accounts for the remaining 25%. The domestic division generates gross margins of 15-16% while the export division generates gross margins of 8%. Within the domestic division, gold jewelry accounts for 72.9% of sales and generates gross margins of 10% while diamond jewelry accounts for 26.5% of sales and generates gross margins of 30-35%.

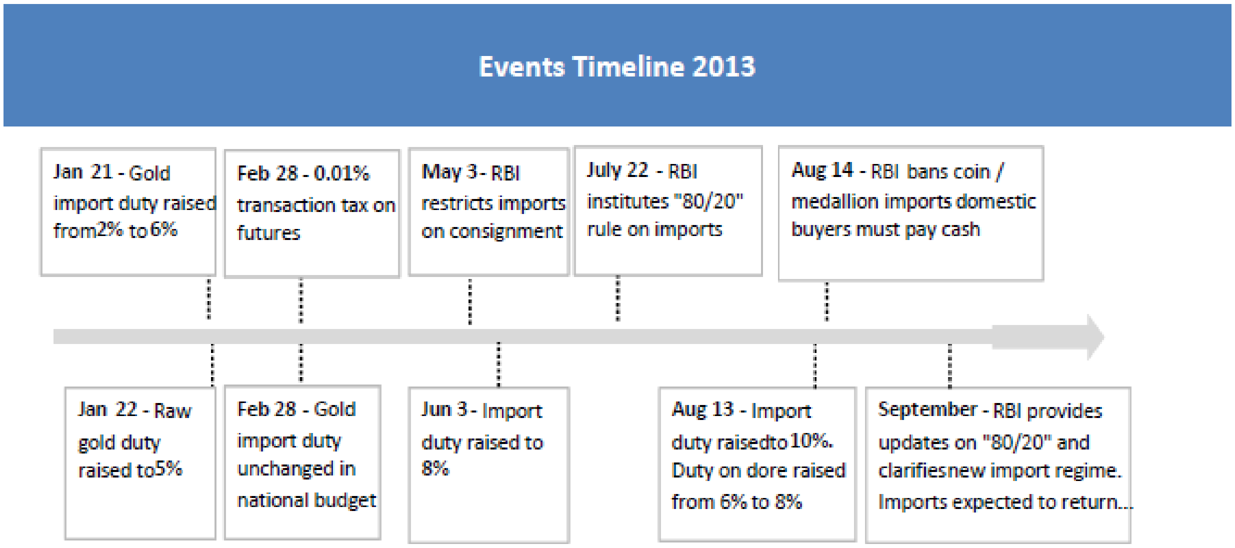


INDIAN GEMS AND JEWELRY INDUSTRY

According to the World Gold Council, India is the largest consumer of gold jewelry in the world at 29% of total consumption. According to CARE, the Indian Gems and Jewelry Export Industry reached US$42.83 billion in 2012 and is expected to grow at 8-10% over the next few years. The Indian gems and jewelry industry has various segments: cut and polished diamonds, gemstones, gold and diamond jewelry, pearl and synthetic stones and others with the two major industry segments in India are gold and diamond jewelry. India also dominates the diamond processing trade with 11 out of 12 diamonds being cut and polished in India. The industry accounted for approximately 14.1% of India's export revenue in fiscal 2012 and directly or indirectly provided employment to approximately 3.5 million people. The low cost of labor and highly skilled labor force are keys to India’s competitiveness in the Global Jewelry Industry.

The domestic jewelry retail industry reached US$45.3 billion (₹2,165.9 billion) in 2012, with gold sales account for 80-85% of the total sales. Government regulation stifled growth over 2013 and the beginning of 2014. Despite the government actions, AT Kearney believes the domestic jewelry retail industry can double over the next 6 years, with growth fuelled by the growing spending power of Indians (economic growth), the increased participation of the modern retail channel (increased advertising) and increased acceptance of wearing jewelry every day. Investment demand accounts for an estimated 45% of total jewelry demand. 57% of investment demand in India comes in the form of coins and bars. PC Jeweller does not sell bars or coins but many of the company’s largest competitors do.

The government took a number of actions to decrease the consumption of gold as gold prices slumped Indian consumers went on a gold buying spree creating a hole in India’s current account deficit. Gold has the second-highest share in imports, increasing from 6% in 2002-2003 to 11% in 2012-2013. The government’s focus was investment demand but the lack of investment infrastructure meant that from a regulatory it was difficult to differentiate between consumption and investment leading to consumption demand being stifled as well. The timeline of regulatory events is listed below.



The regulators increased the import duty to 10%, required 20% of all imports to be re-exported (80/20) and required domestic buyer to pay cash. This eliminated sales generated by credit programs created by many of the retailers. PC Jeweller's credit program was less than 3% of sales but some competitors had significant amount of sales through credit programs. The requirement of domestic buyers to pay cash greatly increased the working capital requirements of the jewelry retailers, as the industry requires significant inventory. Prior to the requirement for cash purchases, retailers financed inventory through gold leases allowing them to hold inventory for 180 days and price it at the time of sales. Only if inventory was held for more than 180 days did retailers take on gold price risk. Gold leasing also came at an interest rate of 3-4% compared to a working capital loan that had an interest rate over 10%. On May 22nd, 2014, the government allowed eased the regulation allowing retailers to lease gold decreasing upfront working capital requirements and financing costs.

The other regulations will be eased as the current account deficit comes under control. Given the importance of gold in the Indian culture, it is difficult to see the regulatory pressure being anything more than a cyclical measure meaning as Government regulations ease growth in the industry should continue.

Industry Structure

The domestic jewelry retailing industry is fragmented with over 450,000 traditional neighborhood jewelers. Over last five years with share of national and regional modern retail chains increased from 3-5% and 7-17% respectively. The table below illustrates store counts of the largest players within the industry.

Competitor	Type	Store Count 2005	Store Count 2010	Store Count 2013
Tanishq	National	84	148	150
Reliance		0	24	51
Joyalukkas		6	22	42
Rajesh Exports		0	30	82
TBZ	Regional	2	14	27
PC Jewellers		1	10	30
Kirtilals		3	7	10

Source: Company data, various new sources

Given there are over 4,500 industry participants it would be hard to argue that any barriers to entry number of participants, there is clearly **no barriers to entry** in the industry. Fragmentation could also be a function of the diversity in cultures throughout India leading to diverse consumer preferences. The growth of modern retailers creates a potential for economies of scale on purchasing, advertising, and the design process. Many participants point to the modern retailers' strength in design as a key selling point over traditional retailers.

Looking at the other four forces, there are a large number of diverse competitors and the customers has very low switching costs pointing to **intensity of rivalry being a strong competitive force**. **The threat of substitute is a weak force. The bargaining power of suppliers of materials is a weak force** particularly for the larger modern retailers as most modern retailers have manufacturing facilities and can easily fully backward integrate. The supply is also a commodity that is a sizeable portion of a retailers' total cost, both factors point to significant price sensitivity. **The bargaining power of suppliers of labor is a strong force** as the industry has an apprenticeship model rather than formal institutional training creating both long training times and a lack of industry best practices and standardization. The industry is not attractive for younger workers so labor may extract more value from the value chain in the future. **The bargaining power of customers is a strong force** as there are low switching costs, many different competitors, the product is a high purchase price item creating an incentive for customers to shop around and customers are more sophisticated than one would think based on where the industry is in its life cycle given the cultural importance of gold. Overall, the five competitive forces point to an industry that should not earn economic profits. A few things ease competitive pressures. The industry growth rates and the traditional retailers are not strong competitors. Competition is predominantly between traditional and modern rather than between modern competitors allowing modern retailers to generate excess profits with more efficient operations. Titan Company and PC Jewellers are the stand out ROIC performers within the sector.

5 Year Average	EBIT Margin	IC Turnover	ROIC	Inc. FC Inv	Inc. WC Inv	Altman Z Score	Net Debt/EV
PC Jeweller	7.9%	3.95	31.0%	17.0%	42.7%	3.79	18%
Titan	6.0%	12.37	74.3%	-0.2%	13.4%	7.43	0%
Tribhovandas Bhimji Zaveri Ltd	5.4%	3.37	18.1%	6.6%	61.4%	4.83	28%
Gitanjili Gems	3.7%	1.82	6.8%	1.0%	12.9%	3.05	89%
Thanga Mayil Jewellery Ltd	5.7%	3.33	18.9%	4.5%	21.8%	3.88	53%
C Mahendra Exports	3.6%	1.57	5.7%	-0.4%	29.4%	3.39	47%
Shrenuj & Company Ltd.	3.7%	1.82	6.8%	1.0%	12.9%	3.06	87%

Source: Company data, Reperio Capital Research estimates

Titan generates the highest ROIC in the sector. Titan is the largest jewelry retailer with international operations and the largest domestic store count. Titan and PC Jewellers also has the best brand recognition of all companies within the sector with a recent survey showing 100% percent of the respondents are aware of Tanishq (Titan) followed by PC Jewellers (84%), Mehrason (84%), Nakshatra (81%), Sanchi (77%) & Gitanjali (63%).

Strong margins, through superior design, and better than average IC Turnover drives PC Jeweller strong ROIC performance. In PC Jeweller's export business, the company generates substantially higher margins than peers due to the company's strength in design. In the domestic business, PC Jeweller's strength in design and high share of diamond jewelry sales relative to the overall market drive the strong performance.

During the period of intense regulatory pressure, Titan Company and PC Jeweller were the only large retail companies able to maintain net margins above 5%, illustrating the strength of both companies.

Net Margin	11-Dec	12-Mar	12-Jun	12-Sep	12-Dec	13-Mar	13-Jun	13-Sep	13-Dec	14-Mar
PC Jewellery					6.6%	7.2%	6.5%	9.2%	6.2%	5.4%
Titan	6.7%	6.3%	7.1%	8.0%	6.8%	7.1%	5.9%	8.2%	6.2%	7.4%
Tribhovandas Bhimji Zaveri Ltd	4.5%	2.8%	5.8%	5.4%	4.3%	5.6%	3.9%	1.1%	3.7%	2.6%
Gitanjili Gems	3.7%	2.9%	4.4%	3.9%	4.0%	2.5%	0.9%	1.3%	1.8%	
Thanga Mayil Jewellery Ltd	5.5%	3.0%	4.2%	3.4%	1.8%	-1.6%	3.2%	0.2%	-2.6%	
C Mahendra Exports		3.7%	0.1%	2.8%	1.2%	3.0%	3.9%	-3.4%	0.2%	
Surana Corp Ltd	0.7%	0.4%	1.1%	1.1%	0.6%	0.4%	0.7%	-4.8%	-22.2%	
Shrenuj & Company Ltd.	2.1%	1.6%	1.8%	2.3%	1.5%	3.3%	1.7%	2.2%	1.6%	2.2%

Source: Company data, Reperio Capital Research estimates

MANAGEMENT TEAM

PC Jeweller's management team has done a good job of navigating the highly competitive Indian Jewelry industry in a profitable manner. The strength of managements operating ability is illustrated by the strength of the company's growth and ROIC relative to peers.

7 Year Average (FY08-FY14) (6/13/2014)	Sales CAGR	Op Pr CAGR	OP Margin	IC Turnover	ROIC	Altman Z Score	Net Debt (MRQ)/EV	PE TTM	EV/Op Prof TTM
PC Jeweller	**59.7%**	**72.6%**	**9.6%**	**3.57**	**34.5%**	**3.79**	**20%**	**5.6**	**4.2**
Titan	23.8%	27.5%	8.9%	14.05	125.0%	7.43	0%	38.3	27.0
TBZ	26.7%	33.5%	6.7%	2.99	20.2%	4.83	27%	24.0	13.6
Gitanjili Gems	17.1%	16.3%	6.6%	1.63	10.7%	3.05	90%	24.3	9.4
Thangamayil	32.2%	7.6%	7.5%	3.02	22.5%	3.88	50%	NA	11.3
C Mahendra	19.7%	10.7%	7.2%	1.49	10.7%	3.39	47%	241.2	23.2
Surana	16.4%	+ to -	2.3%	8.32	19.2%	6.21	91%	NA	NA
Shrenuj	24.9%	12.7%	7.8%	1.63	12.7%	3.06	87%	12.9	34.5

Source: Company data, Reperio Capital Research

As illustrated above, from FY2008-FY2014, PC Jeweller has the fastest sales and operating profit growth, the highest operating profit margin in the industry, and with the exception of Titan and Surana, IC Turnover well above all industry peers. PC Jeweller's margin strength is related to the focus on competition on design rather than price.

During this period of heavy investment in showrooms and infrastructure, PC Jeweller's margins expanded at twice the pace of its closest competitor.

Operating Margin	2008	2014	Margin Expansion
PC Jeweller	**6.9%**	**11.1%**	**4.1%**
Titan	8.2%	9.7%	1.5%
TBZ	5.3%	7.3%	2.0%
Gitanjili Gems	5.7%	5.4%	-0.2%
Thangamayil	5.6%	1.6%	-4.0%
C Mahendra	8.0%	5.0%	-3.0%
Surana	3.8%	-5.1%	-8.9%
Shrenuj	10.0%	5.4%	-4.6%

Source: Company data, Reperio Capital Research

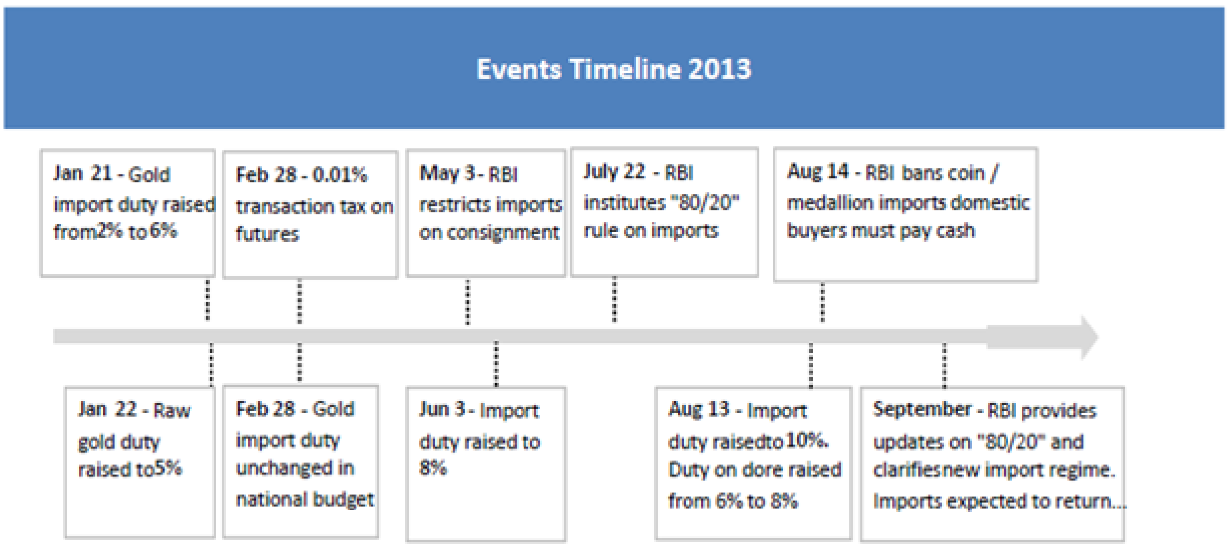
During this same period, PC Jeweller has increased its showroom count from 3 at the end of FY2008 to 41 at the end of FY2014 with all key measures growing by 20% per year.

Growth	2009	2010	2011	2012	2013	2014	CAGR
Store Count growth	67%	100%	70%	41%	25%	37%	42%
Sq. Ft growth	27%	88%	56%	37%	19%	45%	38%
EBIT per share growth	35%	105%	97%	60%	26%	5%	43%
EPS growth	-18%	261%	111%	54%	16%	0%	54%
BVPS growth	54%	53%	105%	60%	87%	21%	50%
Blended Intrinsic Value per share growth	36%	4%	49%	39%	47%	9%	23%

Source: Company data, Reperio Capital Research est.

The strength of operations and growth has not been at the expense financial health as illustrated above.

The strength of PC Jeweller's management is further evident during this recent period of industry weakness. Government regulations implemented to ease demand of gold and help the current account deficit in India lead to a very tight supply. The timeline of regulations are illustrated below.



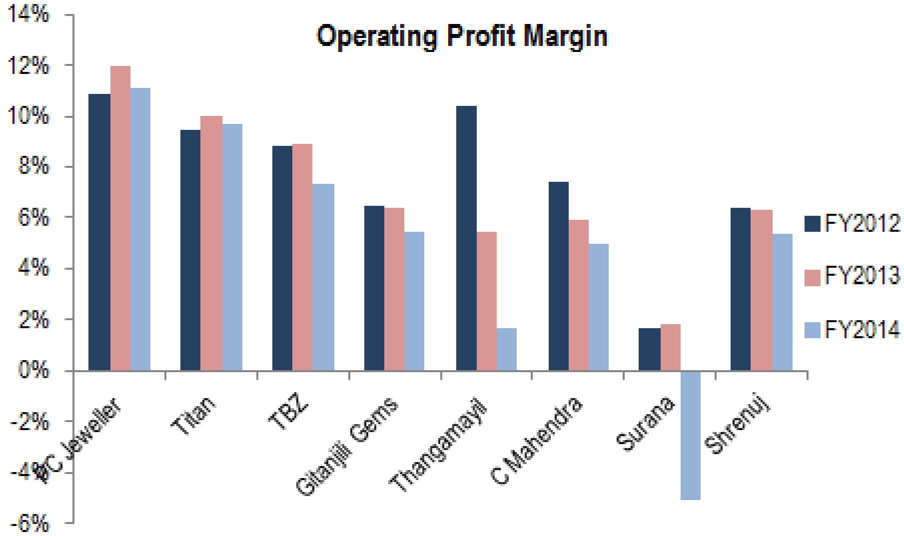
The fiscal year of jewelry retail companies in India ends in March therefore the first regulations had an impact at the end of FY2013. Jewelry retailers felt the real impact of regulation starting FQ2 2014. The RBI instituted the 80/20 rule requiring 20% of all imported jewelry to be re-exported. Jewelry retailers with export businesses were beneficiaries. Also in FQ2 2014, The RBI banned all non-cash payments for coin and medallion imports. This ended the gold lease program that jewelry retailers used to acquire working capital forcing these companies to take a bank loan increasing financing costs from 3-4% on gold leases to 8-12% for short-term bank loans.

From FY2012-FY2014, PC Jeweller had the fastest sales growth of all players in the industry at 39.1% compared to an average CAGR of 15.7%. In FY2014, when the regulatory environment started affecting the industry, PC Jeweller's sales growth continued at 32.5% while the industry average sales growth rate slumped to -3.9%. This illustrates both the strength of management as operators and their long-term view, as management is looking past short-term weakness associated with cyclical regulations.

Sales Growth	FY12	FY13	FY14	FY12-FY14 CAGR
PC Jeweller	**53.9%**	**32.1%**	**32.5%**	**39.1%**
Titan	35.4%	14.4%	6.8%	18.3%
TBZ	16.0%	19.7%	9.6%	15.0%
Gitanjili Gems	32.1%	31.4%	-24.3%	9.5%
Thangamayil	72.0%	34.6%	-21.5%	22.1%
C Mahendra	4.3%	18.8%	-3.5%	6.1%
Surana	62.9%	-2.3%	-51.3%	-8.1%
Shrenuj	28.1%	22.6%	20.2%	23.6%

Source: Company data, Reperio Capital Research

FY2012-FY2014 Operating Margins of PC Jeweller's and its peers are shown in the chart below. Other than PC Jeweller and Titan, all peer saw an average margin contraction of 3.6% over the past two fiscal years, further evidence of the operating strength of PC Jeweller relative to peers.



Source: Company data

The company capital allocation is sound. The company pays a small but increasing dividend with the remaining cash going to store expansion, an intelligent move as the company is generating ROIC well above its cost of capital and each dollar of growth generates three dollars of value at the lower end of historical ROIC.

Management is doing a good job of focusing on increasing long-term intrinsic value and their incentives are aligned with minority shareholder with key management wealth tied to share prices rather than salary.

	Compensation (Rs mn)	Shares Owned (mn)	Current Price	Value of Share (Rs mn)	Multiple of Salary
Mr. Padam Chand Gupta	0.10	51.46	123.15	6,337	64,662
Mr. Balram Garg	60.00	66.04	123.15	8,133	136
Mr. Krishan Kumar Khurana	0.78	-			
Dr. Manohar Lal Singla	0.64	-			

Source: Company data

Company Strategy

PC Jeweller strategy is to continue to expand the number of large format showrooms (>3,500 sq. ft.) to create a pan-Indian presence focused on the wedding segment. The company expects to open 100,000 sq. ft. in 15 showrooms in FY 2015.

The company is trying to increase the amount of diamond jewelry sold as a percentage of total sales, as illustrated in the revenue breakdown chart above diamond jewelry has 30-35% gross margins compared to 10% gross margins for gold jewelry. Gold jewelry increased as a percentage of sales in FY2014 due to the fall in gold prices making the gold more attractive on a relative basis.

Revenue Breakdown	2010	2011	2012	2013	2014
Gold Jewelry	81%	76%	73%	69%	73%
Diamond Jewelry	18%	23%	27%	31%	26%
Other	1%	1%	1%	1%	1%
Geography of Sales	**2010**	**2011**	**2012**	**2013**	**2014**
Domestic	67%	66%	67%	74%	75%
Export	34%	34%	33%	26%	25%

Source: Company data

The company is trying to maintain exports as a consistent portion of revenues to help buffer against regulatory risk, particularly the 80:20 rule stating 20% of gold imported must be re-exported.

The company has been making strides at creating a national brand through advertising and sponsorships. From 2008 to 2013, the company only spent 81bps of sales on advertising. If branding creates significant value, the company should be spending more on advertising.

VALUATION

Growth

Who knows what the future holds or what growth PC Jeweller will see. The industry is highly regulated and macroeconomic concerns persist both globally and in India. Although the future growth rate is very uncertain, the drivers of growth are in place. As illustrated below, India's GDP per capita is low relative to the rest of the world allowing for ample room for economic growth. India's debt levels are low relative to the rest of the world eliminating the burden of debt. India's organized retail sector contribution is a small percentage of the overall market as India matures so should its organized retail sector.

Country Name	GDP Per Capita (2012)	Domestic Credit provided by Banking Sector % GDP (2012)	Organized % of Retail Sales
India	**1,503**	**75.89**	**4%**
Philippines	2,587	50.88	35%
Indonesia	3,557	42.62	30%
Thailand	5,480	169.61	40%
China	6,091	155.12	20%
World	**10,318**	**167.22**	**40%**
Malaysia	10,432	133.99	55%
Korea, Rep.	22,590	168.70	15%
United Kingdom	38,920	206.66	80%
United States	51,749	229.87	85%

Source: World Bank, Impact of Organized Retailing on the Unorganized Sector

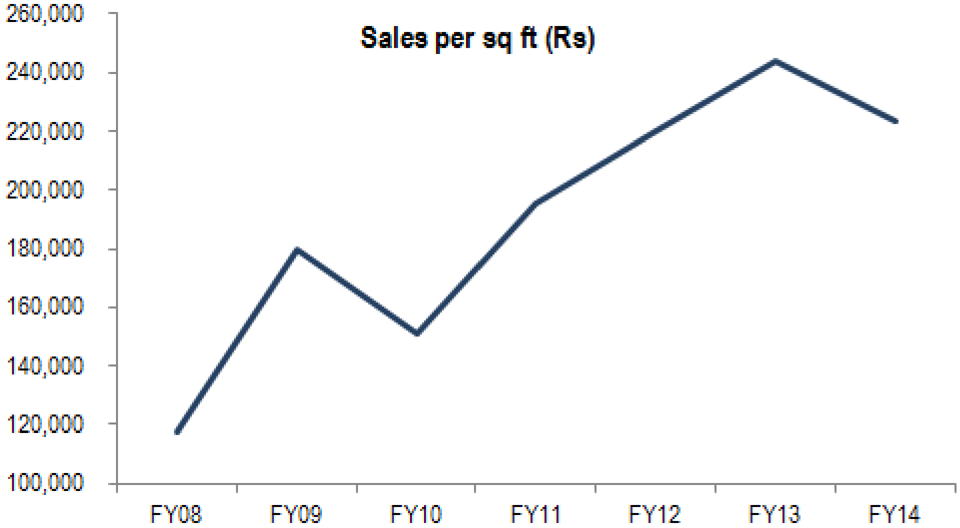
PC Jeweller has a history of showroom growth and the company's ambitions are for many more showrooms. The company has the ambition and the market has the room for PC Jeweller to reach at least 100 stores, which seems to be a target for the company although it has not officially stated such.

Growth	2009	2010	2011	2012	2013	2014
Store Count growth	67%	100%	70%	41%	25%	37%
Sq. Ft growth	27%	88%	56%	37%	19%	45%
EBIT per share growth	35%	105%	97%	60%	26%	5%
EPS growth	-18%	261%	111%	54%	16%	0%
BVPS growth	54%	53%	105%	60%	87%	21%
Blended Intrinsic Value per share growth	66%	-5%	59%	53%	27%	27%

Source: Company data, Reperio Capital Research est.

There is a high degree of confidence double digit growth will persist for at least the next five years and more likely ten years, but the stock is price for a contraction in the industry.

The company's top line will continue to grow as the company is targeting a 36% increase in showroom count and a 42% increase in gross square footage in FY2015. With the exception of regulatory constraints (FY2014), cyclicality (FY2014) and a year when gross square footage increased by 87% (FY2010), PC Jeweller continues to improve its sales per square feet, which increased by 11% per year from ₹117,811 in FY2008 to ₹223,732 in FY2014. The company's top line improvements per square foot should lead to growth above capacity growth.



Source: Company data

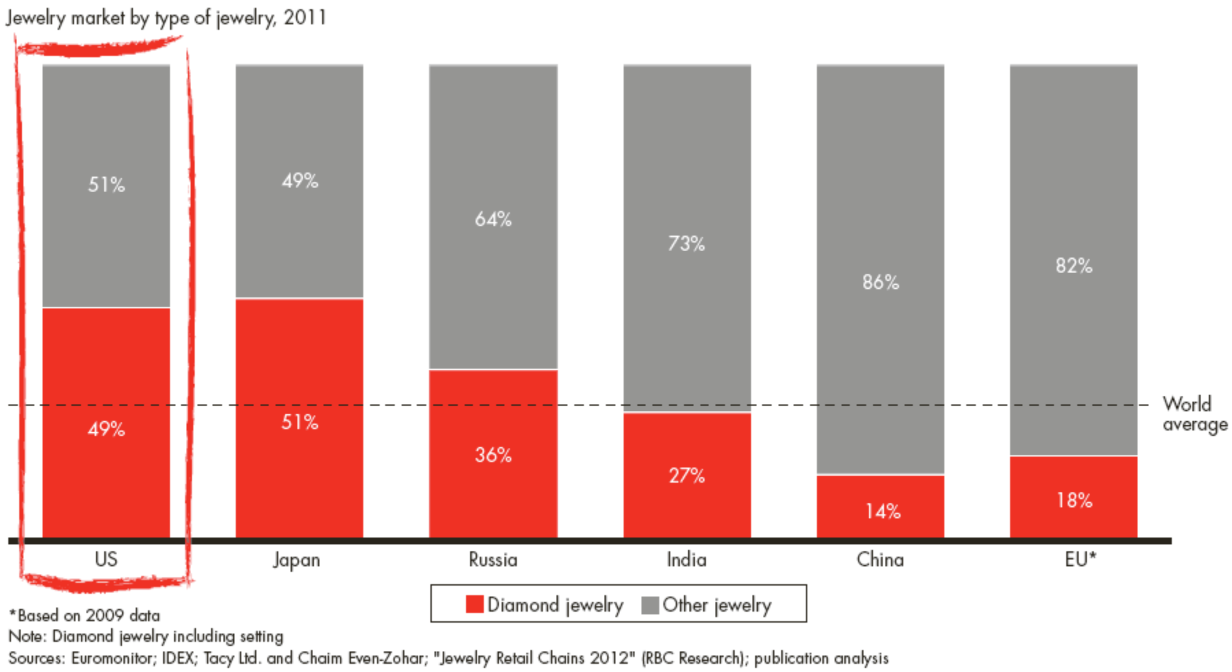
PC Jeweller's continues to improve its operating margin with the company has reported operating margin improving from 4.64% in FY2008 to 8.81% in FY 2014. The key drivers of PC Jeweller's operating margin improvement are decreasing export sales and increased diamond sales.

Gross Margins	
Domestic Sales	
Gold Jewelry	10%
Diamond Jewelry	30-35%
Export Sales	8%

Source: Company data

Longer-term export sales should continue to decrease as a percentage of sales but in the short-term export sales will remain around 25% of sales as a recent RBI regulation requiring export of 20% of gold imported favors jewelry companies with export sales. In the past year, gold supply has been tight and PC Jeweller believes it received preferential treatment from bullion banks due to its export sales. Titan Company, the largest jewelry company in the country, also mentioned a shift toward export sales (currently 0% of sales) to make the acquisition of gold easier. Prior to the regulation, PC Jewelers' management discussed decrease the percentage of export sales.

Margin expansion from increased diamond sales may or may not be a driver of future earnings growth. AT Kearney estimates diamond only accounts for 15% of total jewelry retail sales in India while Bain & Co estimates diamond sales are closer to global average at 27% of total jewelry retail sales.



Overall, should continue to increase primarily driven by PC Jeweller's showroom expansion with management targeting a square footage increasing of 42% in FY2015. Additional upside to earnings growth may come from an increase in sales productivity, margin improvement, a decrease in exports sales, and an increase in diamond sales as a percent of total sales.

IRR Valuation

PC Jeweller is trading on an EV/EBIT of five times. It seems irrational for a company that is one of the strongest operators in its segment, with good capital allocation, a franchise value of almost three, and a long runway for growth to trade at a pre-tax income yield of 20% almost two times the AAA corporate bond yield in India. PC Jeweller has no corporate governance issues, no business quality issues, and no financial health issues, yet is offering a 100% return of capital in three and half years, assuming a full payout of EBIT.

Assuming the company can double its store count in the next five years and there are no operational improvements or changes to the competitive landscape, PC Jeweller will be on an EBIT yield of 40% in five years.

No Growth Valuation

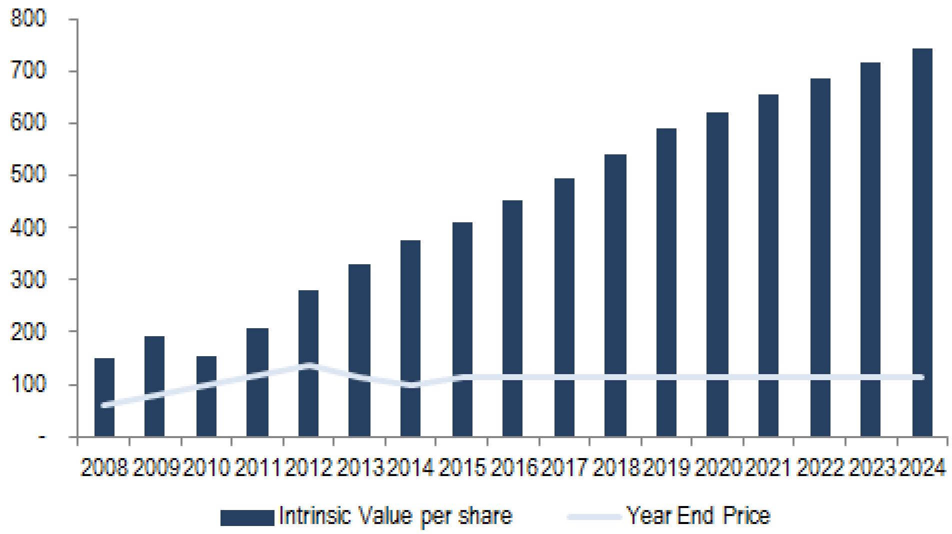
			FY2008-2014			
Assumptions	**First 5 Years**	**Terminal Rate**	**Average**	**Peak**	**Trough**	**St Dev**
WACC	12.5%	12.5%				
Sales Growth	0.0%	0.0%	61.9%	100.7%	32.1%	29.5%
Operating Margin	11.0%	11.0%	11.0%	12.8%	7.7%	1.8%
Tax Rate	10.5%	35.0%	10.5%			
Fixed Capital Investment Rate	2.7%	2.7%	2.7%	4.3%	1.1%	1.5%
Working Capital Investment Rate	42.7%	42.7%	44.4%	58.5%	17.3%	16.4%
Dividend Payout Ratio	0.0%	0.0%	-26.3%	0.0%	-136.9%	49.4%

Source: Reperio Capital Research

Using the assumptions of key value drivers illustrated above, PC Jeweller has a blended valuation of ₹227 per share. Operating margin is higher than the financial ratios above as rent expense is capitalized and added to debt. Finance charges for working capital are moved below the operating line, removed from working capital and added to debt. Both reflect the underlying economics of the transactions.

The table and chart below show intrinsic value per share progression of PC Jewellers.

PC Jeweller (PCJEWELLER:NSI)	2010 FV (INR)	2011 FV (INR)	2012 FV (INR)	2013 FV (INR)	2014 FV (INR)	2015 FV (INR)	2016 FV (INR)	2017 FV (INR)	2018 FV (INR)	Weight
EVA Total Return	53.5	73.6	114.4	159.6	187.2	204.4	230.3	255.7	280.7	20%
DCF Total Return	84.5	88.1	76.7	135.4	173.3	243.5	270.2	296.6	322.6	20%
Earnings Power Value per share	34.5	84.6	159.8	162.8	243.0	233.6	233.6	233.6	233.6	20%
Earnings Power Value w/ Terminal Growth Rate	34.5	84.6	159.8	162.8	243.0	233.6	233.6	233.6	233.6	20%
Target Multiple	60.0	94.0	137.9	203.3	200.6	219.7	248.9	278.1	307.3	20%
Blended fair price	**53.42**	**84.98**	**129.69**	**164.75**	**209.41**	**226.96**	**243.31**	**259.51**	**275.55**	
Recent price (5/23/2014)	98.71	117.86	137.00	114.40	96.80	123.15	123.15	123.15	123.15	



Source: Reperio Capital Research est.

The table below shows the sensitivity of the Target Price to changes in key value drivers.

FY 2015 Target Price Sensitivity- WACC & Terminal Growth Rate

Terminal Growth Rate \ WACC	10.0%	11.0%	12.0%	13.0%	14.0%	15.0%	Δ
0.0%	281	256	236	219	203	190	-6%
1.0%	290	264	242	223	207	193	-7%
2.0%	302	273	248	228	211	196	-7%
3.0%	317	284	256	234	215	199	-7%
4.0%	337	298	267	242	221	204	-8%
5.0%	365	316	280	251	228	209	-9%
Δ	6%	5%	4%	3%	2%	2%	

Source: Reperio Capital Research

FY2015 Target Price Sensitivity- Operating Margin & Forecast Period Sales Growth

Forecast Period Sales Growth	Adjusted Operating Margin						
	7.5%	9.0%	10.5%	12.0%	13.5%	15.0%	Δ
0.0%	161	190	218	246	274	301	12%
5.0%	165	196	227	258	289	319	12%
10.0%	169	204	238	272	306	339	13%
15.0%	174	213	251	288	326	364	15%
20.0%	180	224	266	308	351	393	16%
25.0%	188	237	285	333	381	428	17%
Δ	1%	1%	1%	1%	2%	2%	

Source: Reperio Capital Research

Relative Valuation

5 Year Average	ROIC	Net Debt/EV	PE TTM	EV/Op Prof TTM
PC Jeweller	31.0%	18%	6.2	4.6
Titan	74.3%	0%	39.0	27.5
Tribhovandas Bhimji Zaveri Ltd	18.1%	28%	22.3	12.9
Gitanjili Gems	6.8%	89%	3.7	8.7
Thanga Mayil Jewellery Ltd	18.9%	53%	100.2	10.8
C Mahendra Exports	5.7%	47%	74.7	23.3
Shrenuj & Company Ltd.	6.8%	87%	12.9	34.5

Source: Company data, Reperio Capital Research estimates

On an EV/EBIT basis, PC Jeweller trades at a significant discount to industry peers despite the strength of the PC Jeweller's profitability, growth outlook and financial health. There are no corporate governance issues, which would warrant the valuation discount. Titan is the clear leader in the sector and warrants a premium but PC Jeweller should trade at a premium to all other players.

The company is trading at low valuation because of a lack of coverage, regulatory pressures on the industry and cyclicality. Those with a short-term investment horizon shun the uncertainty of not knowing when regulatory pressures will be alleviated from the industry.

RISKS

As illustrated over the past two years, the biggest risk for PC Jeweller and the jewelry industry is regulatory risk. As the industry matures, the infrastructure for investment demand and consumer demand for gold should mature and separate. Given the regulators were targeting investment demand, this maturation should lead to less regulatory risk going forward.

Growing competition from the modern and traditional retailers in the form of better product offering is always a concern.

Expansion outside of Delhi NCR could lead to weaker returns as the company moves outside of a region, where its brand is well known and it understands the design requirements of the local culture.

Tightness in supply of skilled labor could be an issue in the future as the industry is not attractive to younger workers and there are no formal training programs to create best practices for the industry.

Jewelry is a traditional investment vehicle for Indians as the financial system matures and confidence in the system grows there could potentially be disinvestment in gold in favor of modern savings platforms. If the Reserve Bank of India were to tame inflation for an extended period, investment in gold may decline as well.

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