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## India Discovery

### Shrenuj & Co. Ltd.

### (SHRE.BO) – Company Visit

**Conclusion:** Shrenuj & co. Ltd is a diamond cutting and polishing company based out of Mumbai with jewellery manufacturing and retailing as other business segments. We visited Shrenuj last week, with management underscoring the message of the company as a beneficiary of India's growing domestic as well as export jewellery market. Similar to other jewellery companies, it is focusing on increasing its profitability by going downstream. It has strong upstream capabilities in diamond polishing and jewellery manufacturing as well as distribution. The management targets US\$1 billion in sales by F2012.

**What's New:** Shrenuj has a different business model to other jewellery companies in India. It focuses on higher caratage diamonds for cutting and polishing as compared to the smaller low caratage diamonds typically processed in India. This allows them to earn higher margins as well as attract a more affluent customer base. The company also intends to become a fully integrated jewellery player with operations spanning diamond polishing to retail. Shrenuj acquired Daily Jewellery in Hong Kong in 2003. Since then it has repositioned the HK company from a discount jeweller to a fashion jeweller. The Hong Kong retail operation currently has 12 stores, which management intends to expand to 20 by next year. Shrenuj also plans to expand retail operations in China and India in the next 3-5 years.

**Implications:** Shrenuj has underperformed the local markets significantly. YTD the stock has underperformed Sensex by 40%. The company has a sound financial track record, increasing sales by 33% and the PAT by 44% CAGR in F03-F07. The stock is trading currently at 9x trailing 12m earnings.

#### Stock Data

Rating	NOT RATED
Ticker (Reuters)	SHRE.BO
Price (12/07/2007)(Rs)	52.1
Market Cap (US\$ mn)	81.5
Foreign Ownership (%)	5%
Outstanding Shares (mn)	62.65
12M Rel. Perf. (%)	-40%

#### Company Description

Shrenuj is a diamond polishing and manufacturing company based out of India. The company also has jewellery manufacturing and jewellery retail as business segments.

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## Focus on Branded Jewellery and Retailing

### Summary & Conclusions

Shrenuj & co. Ltd is a diamond cutting and polishing company based out of Mumbai with jewellery manufacturing and retailing as other business segments. The company's current focus is on branded jewellery and retail in India and China. According to management, the company is currently underutilizing its manufacturing as well as distribution capabilities. It has the capacity to manufacture more than 1-mn pieces of jewellery per year, but is only producing 550,000 pieces at present. Shrenuj is in the midst of setting up a 'hub and spoke' model for jewellery distribution across the globe. Management expects utilization to increase as the hubs settle down. Management also stated that it is engaged in boosting its distribution network.

### Retail Plans

Shrenuj has identified retail as a key growth area, which it expects to drive an increase in margins. It plans to increase retail operations in India and China, which are the biggest jewellery trading centers globally. The company already operates 12 retail jewellery outlets in Hong Kong, which it plans to increase to 20 in the next year. From this initial base, the company plans to launch an advertising campaign and enter the Mainland China market.

In India, Shrenuj launched its retail brand *Diti* in 2HF2006 at three different locations. *Diti* is a shop-in-shop model in which the company displays its brands through small independent retailers. The retailers get a cut on the retail price in the form of rental payments. The average price point of the *Diti* brand is Rs8,000 per piece, and the jewellery has been positioned as a fashion brand and the company certifies each jewellery piece.

Exhibit 1

### Domestic Retail Expansion Plans

	No of <i>Diti</i> stores f
F07	3
F08	30
F09	100
F10	170
<b>Post F10</b>	<b>Exclusive <i>Diti</i> stores</b>

Source: Company data, Morgan Stanley Research

The company expects to derive 10% of its revenues from retail operations in F2010, investing a planned Rs80mn in branding and Rs140 mn in retail.

Exhibit 2

### Domestic brand - Diti



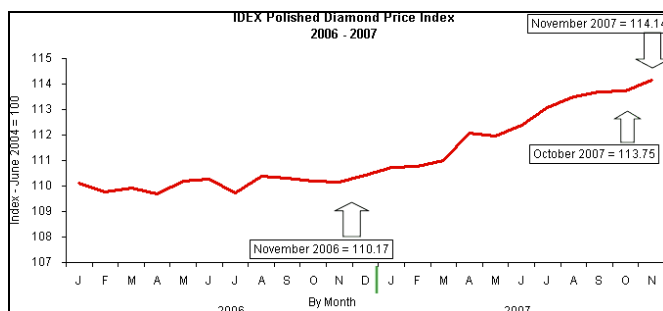
Source: Company data

### Diamond Polishing

The company has focused on polishing high caratage diamonds and has a range of polishing diamonds from 1 carat to 50 carat. The company directly competes with the Belgian diamond polishers since the Belgian companies are preferred for the bigger size (caratage) diamonds cutting and polishing. This high caratage gives them bigger and affluent customer base and assured offtake. Polished diamond prices have been increasing over the last couple of months. The price increase has predominantly occurred in higher caratage diamonds.

Exhibit 3

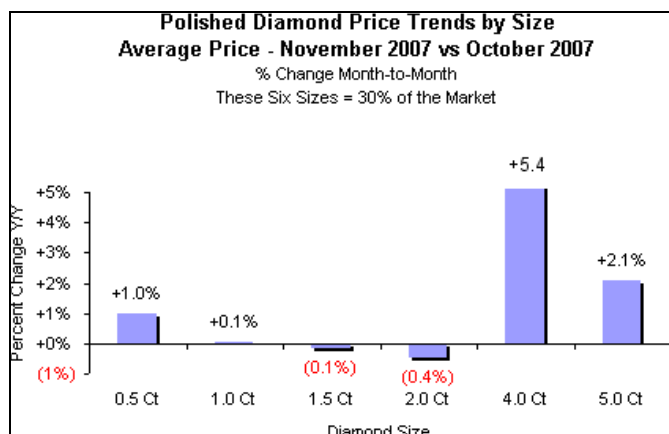
### Diamond Price Index on an Upward Trend



Source: IDEX Newsletter

Exhibit 4

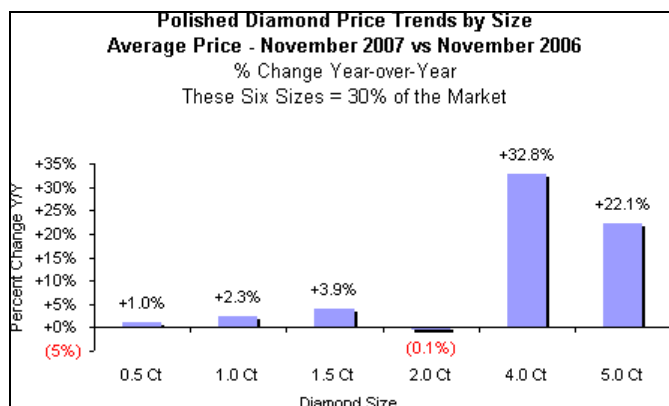
## Diamond Price Increase Occurring in Higher Caratage Diamonds (MoM growth)



Source: IDEX Newsletter

Exhibit 5

## Price Increases are Significant YoY



Source: IDEX Newsletter

## New Acquisitions

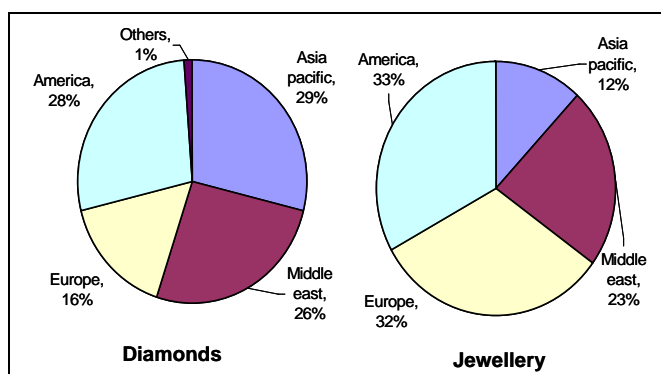
The company recently acquired Simon and Golub & Sons (SGS), which is a US-based jewellery distribution company, supplying some US\$100 mn of jewellery to majors like JC Penny, Zale and Walmart on a commission basis. It also supplies to independent retailers. It has 650 active client accounts out of a total of 2,500 clients. Shrenuj acquired an 88% stake in this company for US\$23 mn financing through Foreign Currency Convertible Bond (FCCB) and long-term debt. Shrenuj expects to increase its own share of SGS' sales from US\$10 mn to US\$50 mn in the next three years.

## Well Diversified Sales

Shrenuj has a geographically diversified sales base, which gives it a natural hedge against currency fluctuations. The company's client base is fairly large with more than 2000 customers and the hub and spoke model should help it to increase the client base and reduce the dependency on one customer or one region.

Exhibit 6

## Geographical Diversification for F2007



Source: Company data

## Sound Financials

The company has grown its sales by 32% CAGR in the period F03-07. The bottom-line has steadily grown by 47% pa, and company management is confident of sustaining these growth levels for the next five years. The company recently concluded an FCCB of US\$15mn, which was entirely subscribed for by Lehman Brothers. The proceeds were utilized to fund the SGS acquisition.

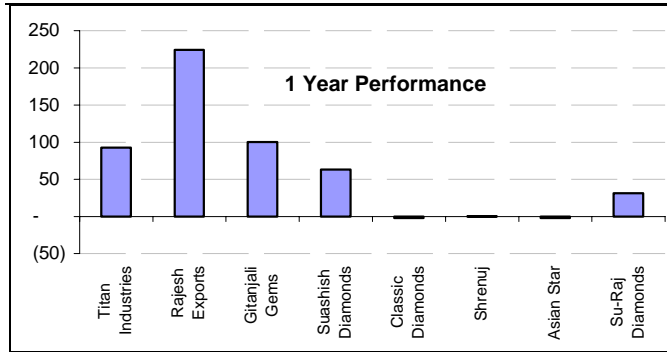
## Price Performance

The stock has underperformed the local market by 40% despite the decent financial and operating performance.

December 7, 2007  
India Discovery

Exhibit 7

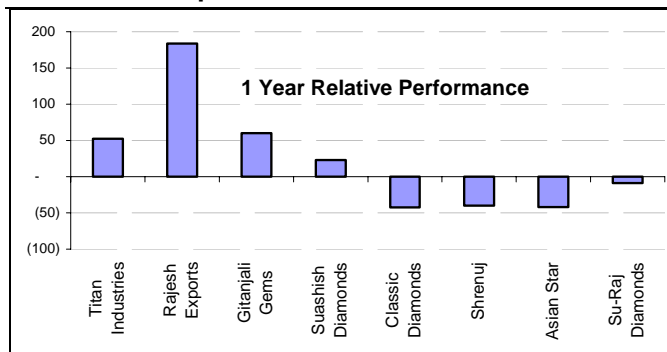
## The Stock has Been Flat over Past Year



Source: Company data, Morgan Stanley Research

Exhibit 8

## Massive Underperformance vs Index



Source: Company data, Morgan Stanley Research

Exhibit 9

## Shrenuj Price Performance



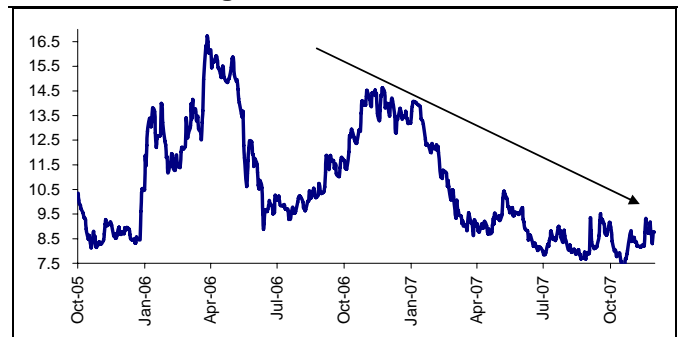
Source: Company data, Morgan Stanley Research

## Valuations

The stock is trading at 9x 12m trailing EPS.

Exhibit 10

## 12-month Trailing P/E



Source: Company data, Morgan Stanley Research

December 7, 2007

India Discovery

## Financials

Exhibit 11

### Shrenuj: Income Statement

Yr to March (Rs mn)	2003	2004	2005	2006	2007
INCOME					
Sales Turnover	3,185	4,626	5,583	6,478	9804.2
Other Income	1.4	2	15.8	11.9	678
Total Income	3,187	4,628	5,599	6,490	10,482
EXPENDITURE					
Stock Adj	(306)	21	(56)	(702)	(1161.9)
Raw Materials	2,896	3,738	4,521	5,858	8841.8
% of Sales	81	81	80	80	78
Power & Fuel Cost	9	15	17	22	15.8
Employee Cost	57	92	131	182	311.5
Other Manufacturing Expenses	171	259	295	247	312.3
% of Sales	5.4	5.6	5.3	3.8	3.2
Selling and Administration Expenses	79	131	224	244	410.4
% of Sales	2.5	2.8	4.0	3.8	4.2
Miscellaneous Expenses	38.6	59.4	73.7	82.7	146.6
Total Expenditure	2,946	4,315	5,205	5,932	8,877
% of Sales	92	93	93	92	91
Operating Profit	241	313	393	558	996
% of Sales	7.6	6.8	7.0	8.6	10.2
Interest	132	174	170	226	436
Gross Profit	109	138	223	333	560
Depreciation	17	25	35	42	53
Profit Before Tax	92	113	188	291	507
Tax	13	23	55	93	166
Deferred Tax	9	12	12	7	5
Tax as % of PBT	23	31	35	36	35
Net Profit before Minority Interest	70.4	78.2	121.4	186.5	328.6
Minority Interest	0	-5.8	0.8	-8.7	-11.4
Net Profit after Minority Interest	70.4	84	120.6	195.2	340
Extraordinary Items	-3	0.2	-1.1	-0.3	-2.2
Adjusted Net Profit	73.4	83.8	121.7	195.5	342.2

Source: Company data, Morgan Stanley Research

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December 7, 2007

India Discovery

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December 7, 2007

India Discovery

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