

February 8, 2008

SHRENUJ & COMPANY LIMITED (SHRENUJ)

CMP: Rs52; STRONG BUY

Eyeing enhanced glitter!

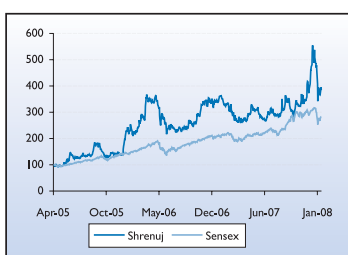
**Initiating Coverage
Target Price: Rs95(Sep'09)**

Bloomberg Code	SJC IN
BSE Sensex	17,527
Nifty	5,133
52-week H/L (Rs)	85/38
Monthly H/L (Rs)	85/41
6 mth avg vol	144,679
Shares O/s (MM)	62.6
MCap (Rs MM)	3,255
MCap (US\$ MM)	81
EV (Rs MM)	8,643

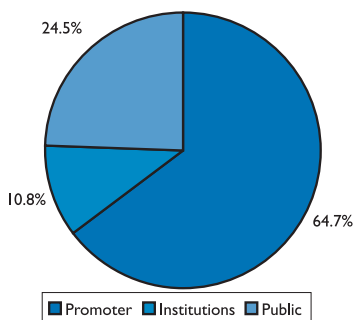
Valuation Parameters (FY10)

P/E (x)	5.5
EV/EBITDA (x)	6.5
P/S (x)	0.3
P/BV (x)	1.0

Price Chart



Shareholding Pattern



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INVESTMENT RATIONALE

DTC Sightholder: Regular supply of rough diamonds

Diamond and Trading Company (DTC) is the rough diamond distribution arm of the De Beers Group. Shrenuj is among the 79 global sightholders for DTC. This ensures guaranteed supplies of rough diamonds at competitive prices.

Change in business strategy: Moving up the value chain

Traditionally, Shrenuj's business activities were confined to diamond processing - accounting for 80% of the revenues in FY07. Lately, the company is changing its business strategy and moving up the value chain i.e. from being a manufacturer-exporter of diamonds and jewellery to retailing and branding of the same. Manufacturing and retailing activities together account for 50-60% of the value chain. Currently, only 20% of jewellery sales are branded. The management plans to take this contribution up to 50% by FY10.

Product-mix to result in improved profitability

The overall strategy of Shrenuj to move up the value chain by increasing the share of retail jewellery business to the overall sales mix is likely to result in increased overall margins for the company. As such, we expect the overall PBIT margins to improve from 9.0% to 10.8% by FY10, as the retail jewellery business gains momentum.

VALUATION AND OUTLOOK

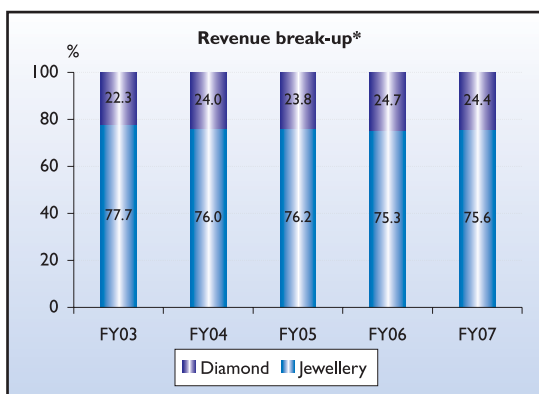
At the CMP of Rs52, Shrenuj is available at 5.5x our estimated FY10 FDEPS. Companies like Rajesh Exports and Gitanjali Gems, who have moved up the value chain, have been able to command higher valuations (10-13x one year forward earnings) than companies engaged purely in diamond processing business. Though Shrenuj is moving towards a more integrated business profile, it will take some time for the stock to trade in line with other more integrated players. Taking into account a 20% CAGR in FDEPS over FY07-10E period and historical P/E valuation band of 7-11x, we have assigned a multiple of 10x to the FY10 EPS of Rs9.5 per share to arrive at target price of **Rs95 per share**. We thus rate the stock as **STRONG BUY** with an upside of 83% by Sep'09.

Rs MM	Net Sales	EBITDA	EBITDA %	PAT	PAT %	No. of Shares (MM)	EPS (Rs)	P/E (X)
FY06 (A)	6,478	547	8.4	196	3.0	54.5	3.6	14.5
FY07 (A)	9,804	939	9.6	340	3.5	62.6	5.4	9.6
FY08 (E)	12,108	1,219	10.1	410	3.4	62.6	6.5	7.9
FY09 (E)	14,076	1,506	10.7	573	4.1	80.7	7.1	7.3
FY10 (E)	16,371	1,857	11.3	765	4.7	80.7	9.5	5.5

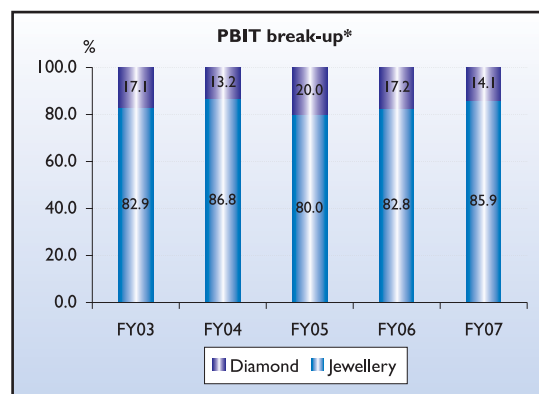
Standalone Financials; (A) Audited; (E) Estimated; FV - Rs 2

COMPANY BACKGROUND

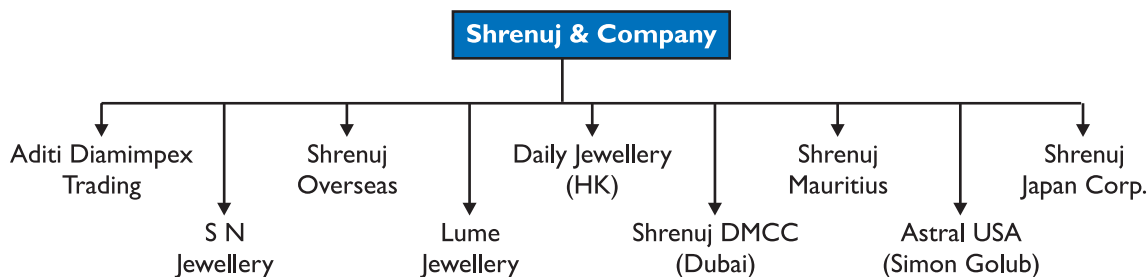
Shrenuj is one of the largest integrated diamond and jewellery manufacturers in India, with presence in the entire value chain - from processing of diamonds to retailing of jewellery. Historically, the company has been focused on diamond processing business - accounted for 80% of the revenues in FY07. Besides, the company also manufactures studded gold/platinum jewellery for export and domestic markets. Shrenuj is changing its business model and moving up the value chain to capture higher margins by increasing its presence in the retail/branded jewellery. Some of the jewellery brands under its fold include *Valena, Fianna, Sveni, Bhavya, Arisia and Joliesse*. The company aims to increase its overseas retailing business through *Simon Golub & Sons* in U.S. and *Joliesse* in Hong Kong. Currently, Shrenuj has five operational jewellery-manufacturing units in Mumbai and the sixth one is expected to be commissioned in 2008.



Source: Company; * excluding inter-segment adjustments



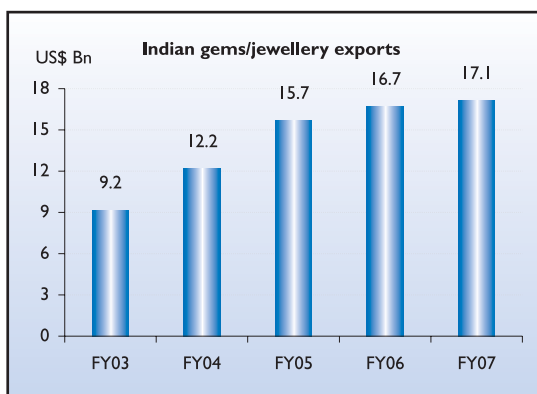
Source: Company; * excluding unallocable expenditure



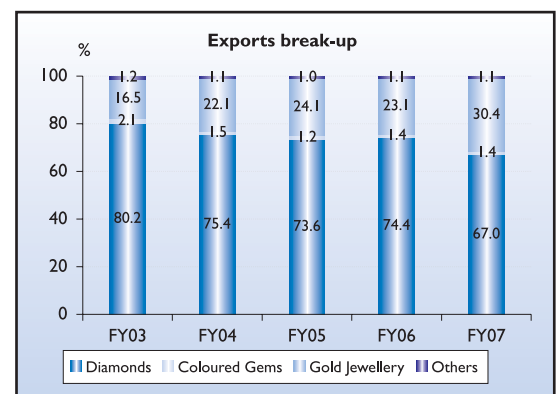
Source: Company

INDUSTRY OVERVIEW

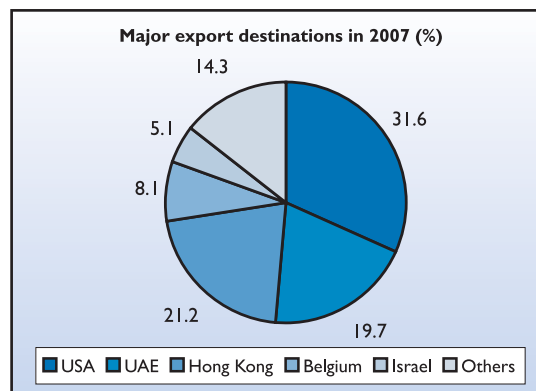
India's gems and jewellery industry is one of the major foreign exchange earners for the country with exports amounting to US\$17.1 Bn in FY07 (about 12% of the total exports). Of this, diamonds and gold jewellery together accounted for more than 97% of the total exports. Low cost of processing and availability of skilled labour are some of the key factors contributing to the competitiveness of India in the global arena. Indian gems/jewellery exports have recorded a 17% CAGR between FY03-07. Major exporting destinations include USA, UAE, Hong Kong, Belgium and Israel.



Source: Gems & Jewellery Export Promotion Council (GJEPC)



Source: GJEPC



Source: GJEPC

INVESTMENT RATIONALE

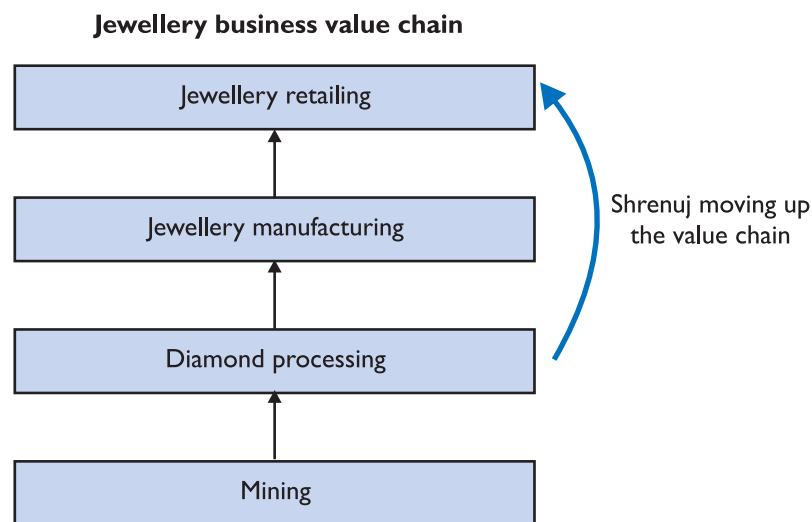
DTC Sightholder: Regular supply of rough diamonds

Diamond and Trading Company (DTC) is the rough diamond distribution arm of the De Beers Group. Its clients known as 'sightholders' are carefully chosen for their ability to add value to the diamonds sold by DTC. These sightholders are based mainly in the traditional cutting centres like Antwerp, Tel Aviv, Mumbai, Johannesburg and New York, as well as in Botswana, Namibia, Russia, China and Thailand. DTC Sightholders are a privileged lot who can make purchases from DTC's sights 10 times in a year in bulk at very competitive prices. For the three year contract period beginning April 2008, DTC has announced a list of 79 sightholders (down from 93 earlier). In India there are currently 28 DTC sightholders (down from 35 earlier).

Shrenuj has long standing relationships with DTC, which ensures regular supply of rough diamonds at competitive prices. Companies without sightholder status have to make open market purchases, which are generally at higher prices. This effectively raises the cost and also results in a loss of guaranteed supplies of rough diamonds.

Change in business strategy: Moving up the value chain

Traditionally, Shrenuj's business activities were confined to diamond processing - accounting for 80% of the revenues in FY07. Lately, the company is changing its business strategy and moving up the value chain i.e. from being a manufacturer-exporter of diamonds and jewellery to retailing and branding of the same. Manufacturing and retailing activities together account for 50-60% of the value chain.



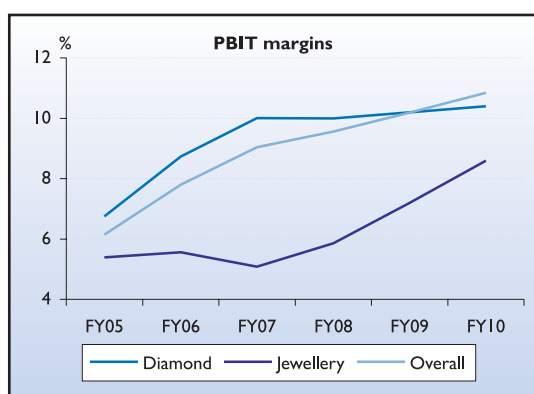
Source: Prime Broking

- **Global distribution model:** In the diamond business, Shrenuj has been traditionally exporting diamonds and jewellery to wholesalers, who in turned supplied to retailers. Shrenuj's strategy has been to establish jewellery and diamond hubs at key distribution centres (Hong Kong, Dubai, New York, and Antwerp) and become direct suppliers to the retailers. This will lead to cutting short of the distribution chain and thereby result in improved profitability for the company.

- **Acquisition of Simon Golub:** In FY07, Shrenuj acquired US based Simon Golub & Sons (SGS) for US\$22.7 MM (Revenues of US\$41.7 MM in CY06). The company operates in two divisions - SG (Trading) and IJC (Services). SG division caters to around 2,200 U.S. retailers out of which 600 accounts are active and generate close to 75% of the revenues. On the other hand, IJC division serves around 30 major clients with a strong region-wise, customer-wise and sales-wise database. This division does not hold stocks and makes direct delivery to clients on which it earns a gross commission of 5-6%. The acquisition will help Shrenuj in increasing the sales of its retail jewellery business (through SG Trading), since SGS will now source diamonds and jewellery from Shrenuj rather than third-party wholesalers. Also, Shrenuj will be able to push its own products along with competitors' products through the service division.
- **Hong Kong operations:** In 2003, Shrenuj acquired *Daily Jewellery* chain in Hong Kong, which was later repositioned as Joliesse - an upmarket jewellery brand. Shrenuj plans to open 18 stores in Hong Kong and make a debut in China with the brand in the next two years.
- **Domestic expansion:** In the jewellery segment, Shrenuj business was more or less confined to the B2B segment (unbranded sales). Shrenuj has now plans to expand its domestic jewellery retail business through shop-in-shops by entering into agreements with various retail chains. *Valena, Fianna, Sveni, Bhavya, Arisia and Joliesse* are some of the well-known jewellery brands under its fold. Currently, only 20% of jewellery sales are branded. The management plans to take this contribution up to 50% by FY10.

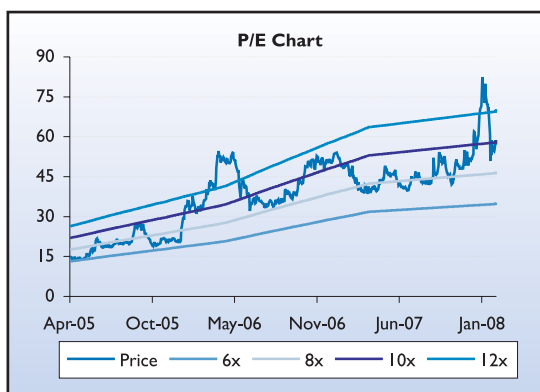
Product-mix to result in improved profitability

The overall strategy of Shrenuj to move up the value chain by increasing the share of retail jewellery business to the overall sales mix is likely to result in increased overall margins for the company. The PBIT margins in the diamond business are ~10%, whereas the same for jewellery business (unbranded) is around ~5%. Retail jewellery, which is presently close to 20% of the total jewellery business, enjoys relatively higher margins (~15%). The management plans to take this contribution up to 50% by FY10. As such, we expect the overall PBIT margins to improve to 10.8% by FY10 (9.0% in FY07), as the retail jewellery business gains momentum.



Source: Company, Prime Broking

VALUATIONS AND OUTLOOK



Source: Prime Broking

At the CMP of Rs52, Shrenuj is available at 5.5x our estimated FY10 FDEPS. Due to commoditised nature of the business and high working capital requirement, gems and jewellery stocks have historically traded at lower valuations (6-10x one year forward earnings). However, companies like Rajesh Exports and Gitanjali Gems, who have moved up the value chain, have been able to command higher valuations (10-13x one year forward earnings). Though, Shrenuj is moving towards a more integrated business profile, it will take some time for the stock to trade in line with other more integrated players.

FY09E Comparative valuation table

Rs MM	Sales	EBITDA	PAT	NPM	P/E (x)	P/S (x)
Shrenuj	14,076	1,506	573	4.1%	7.3	0.3
Rajesh Exports	93,164	4,727	3,074	3.3%	12.9	0.3
Gitanjali Gems	49,143	4,131	2,243	4.6%	11.7	0.5

Source: Prime Broking, Bloomberg

Taking into account a 20% CAGR in FDEPS over FY07-10E period and historical P/E valuation band of 7-11x, we have assigned a multiple of 10x to the FY10 EPS of Rs9.5 per share to arrive at target price of **Rs95 per share**. We thus rate the stock as **STRONG BUY** with an upside of 83% by Sep'09.

Annexure I: Profit & Loss A/c

Rs MM	FY06(A)	FY07(A)	FY08(E)	FY09(E)	FY10(E)
Net Sales	6,478	9,804	12,108	14,076	16,371
YoY growth		51.3%	23.5%	16.3%	16.3%
Total Expenditure	5,931	8,865	10,889	12,571	14,513
EBITDA	547	939	1,219	1,506	1,857
EBITDA Margin	8.4%	9.6%	10.1%	10.7%	11.3%
Depreciation	42	53	61	71	82
Finance Expenses (gross)	225	435	563	592	642
Other Income	12	61	20	20	20
PBT	291	512	614	863	1,153
Tax	104	178	209	293	392
PAT	187	334	406	569	761
Min. interest & Share in associate's P&L	9	6	4	4	4
Net Profit	196	340	410	573	765
YoY growth		73.6%	20.4%	40.0%	33.5%
NPM	3.0%	3.5%	3.4%	4.1%	4.7%
No. of shares (MM)	54.5	62.6	62.6	80.7	80.7
EPS (Rs)	3.6	5.4	6.5	7.1	9.5

(A) Audited; (E) Estimated

Source: Company, Prime Broking

Annexure II: Balance Sheet

Rs MM	FY06(A)	FY07(A)	FY08(E)	FY09(E)	FY10(E)
SOURCES OF FUNDS					
Shareholders Fund	1,359	1,740	2,080	3,393	4,050
Equity Capital	109	125	125	161	161
Reserves & Surplus	1,250	1,595	1,934	3,231	3,889
Share Warrants	-	20	20	-	-
Minority Interest	22	14	14	14	14
Loan Funds	3,859	6,361	6,896	7,031	8,081
Deferred Tax Liability	47	54	54	54	54
Total Funds Employed	5,287	8,169	9,044	10,492	12,200
APPLICATION OF FUNDS					
Net Fixed Assets	710	899	1,170	1,370	1,570
Investments	91	116	116	116	116
Net Current Assets	4,486	7,153	7,757	9,006	10,513
Current Assets	6,024	9,541	10,712	12,436	14,497
Current Liabilities & Provisions	1,537	2,388	2,955	3,430	3,984
Total Net Assets	5,287	8,169	9,044	10,492	12,200

(A) Audited; (E) Estimated

Source: Company, Prime Broking

Annexure III: Cash Flow Statement

Rs MM	FY06(A)	FY07(A)	FY08(E)	FY09(E)	FY10(E)
Profit Before Tax	300	519	618	867	1,157
Add -					
Depreciation as per P&L	42	53	61	71	82
Interest Paid	225	435	563	592	642
Less -					
Other adjustments	11	73	(136)	(95)	(85)
Operating profit befor WC changes:	579	1,079	1,107	1,435	1,796
(Inc)/Dec in Debtors	(712)	(662)	(765)	(604)	(704)
(Inc)/Dec in Inventories	(1,038)	(1,609)	(1,078)	(971)	(1,131)
(Inc)/Dec in Loans and advances	(194)	(380)	(124)	(138)	(161)
Inc/(Dec) in Current Liab. (incl. Prov.)	808	850	567	476	554
Inc/(Dec) in Deferred Tax Liability	7	8	-	-	-
Cash generated from operations	(551)	(713)	(293)	198	354
Direct taxes (income tax + dividend tax)	109	187	218	307	407
Net cash from operating activities	(660)	(900)	(511)	(109)	(53)
Less -					
Change in fixed assets	(122)	(260)	(200)	(200)	(200)
Change in investments	(90)	(26)	-	-	-
Interest Paid	(225)	(435)	(563)	(592)	(642)
Dividend Paid	(38)	(50)	(56)	(81)	(89)
Add-					
Change in Share Capital	-	16	-	36	-
Change in Share Premium	-	-	-	822	-
Proceeds from issue of share warrants	-	20	-	-	-
Change in debt	1,098	2,501	535	135	1,050
Net cash flow for the year	(38)	867	(796)	12	66
Opening Balance	145	107	974	178	189
Closing balance	107	974	178	189	255

(A) Audited; (E) Estimated

Source: Company, Prime Broking

PRIME BROKING



PRIME

Annexure IV: Ratios

	FY06(A)	FY07(A)	FY08(E)	FY09(E)	FY10(E)
EBITDA margin	8.4%	9.6%	10.1%	10.7%	11.3%
EBIT margin	7.8%	9.0%	9.6%	10.2%	10.8%
Net Profit margin	3.0%	3.5%	3.4%	4.1%	4.7%
ROE	13.8%	19.4%	19.7%	16.8%	18.8%
ROCE	9.6%	10.9%	12.8%	13.7%	14.6%
Sales/GFA (x)	7.9	9.8	10.1	10.1	10.2
D/E (x)	2.8	3.7	3.3	2.1	2.0
Current ratio (x)	3.9	4.0	3.6	3.6	3.6
NWC/Sales (excluding cash)	67.6%	63.0%	62.6%	62.6%	62.7%
Debtor days	129	110	112	112	112
Inventory days	185	182	180	180	180

(A) Audited; (E) Estimated

Source: Company, Prime Broking

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STOCK OWNERSHIP / CONFLICT DISCLOSURE

Prime / Prime Subsidiaries	No
Key Prime Management &/or Other Employees	Yes
Any Other Corporate Finance Conflict of Interest	No

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