



JainMatrix Investments

A quality report by [JainMatrix Investments](#)

Rajesh Exports – a Golden Acquisition



- **CMP: Rs. 720**
- **Date: 17th Dec 2016**
- **Advice: Buy Rajesh Exports with a 2 year perspective.**

- **Industry – Gold & Jewellery**
- **Large Cap – 21,300 cr mkt cap**

- **Overview:** Rajesh Exports is an integrated gold firm into refining, jewellery manufacture and retail.
- It had revenues of Rs 50,462 crore and net profits of Rs 655 cr. in FY15.
- The Revenues, EBITDA and Profits are up by 26.5%, 31.8% and 39.9% CAGR over 6 years.
- Key strengths are: large scale operations in gold refining (in India & Switzerland) and jewellery design and mfg. (India). The management appears experienced, capable and shareholder friendly.
- **Why Buy Now:** 1) A recent acquisition of Swiss gold refiner Valcambi will allow the firm to scale up to a globally significant size. 2) The possible synergies with Valcambi include lowering of costs, Europe market access and cooperation on technology and R&D. 3) Growth plans include retail expansion (will improve margins) and Australia mining investments (will tie up ore requirements).
- Even though the share price has appreciated well this year, there is still a good upside visible.

Here is a note on Rajesh Exports Ltd. (REX).

Rajesh Exports – Description and Profile

- REX is a Bangalore based integrated gold and jewellery firm. Started in 1989, it has a presence across the value chain of gold from mining to retail.
- REX had revenues of Rs 50,462 crore and net profits of Rs 655 cr. in FY15. About 90% of revenues are in foreign exchange. It has 358 permanent employees (FY15).
- REX became the largest refiner of gold globally with the acquisition of Swiss firm Valcambi in July 2015. It now processes 35% of global gold, and with the Uttarakhand refinery can refine 2400 tons p.a. of metals.
- REX has gold jewellery mfg. facilities at Bangalore, Cochin and Dubai with a capacity of 350 tons.
- It has R&D facilities in Switzerland & India for innovative jewellery design and a large jewellery database with 29,000 designs. REX exports gold jewellery mainly to USA, UK, Singapore and UAE.
- REX has set up 83 retail showrooms under the brand SHUBH Jewelers since 2010. This jewellery brand is known for quality, designs and value for money. It contributes about 9% of profits with a margin of 7-8%.
- The Leadership-Promoter team is Rajesh Mehta (Chairman), Prashant Mehta (MD) and Vijendra Rao (CFO).
- Shareholding % is: Promoters 53.9, DII 2.5, FII 16.8, Individuals 2.6, Corporates 1.0 and Others 23.2%.

Valcambi Acquisition and Synergies

- REX through its Singapore subsidiary acquired Valcambi in an all cash deal for \$400 m (then Rs 2,560 cr) in July 2015. Valcambi is debt-free with cash surplus of \$150 m.
- Reports so far indicate a smooth transition and integration of Valcambi and REX. The Valcambi management is committed to stay back after acquisition for 5 years.

- Valcambi has the capacity to refine 1,600 tons gold and 400 tons of other precious metals like silver.
- Back end strengths of Valcambi combined with front end strengths of REX provide good synergies.
 - REX can adopt technologies from Valcambi to upgrade and accredit the refining facility in India.
 - REX plans to market designer jewellery in Europe and North America with Valcambi, which has an extensive marketing network in Europe and America.
 - Valcambi was already one of the larger suppliers of gold to REX pre-merger. Other potential gains include sharing gold sourcing synergies, optimizing labour and shared support services.

Value Chain of Gold

The range of REX business activities are explained in Fig 1.

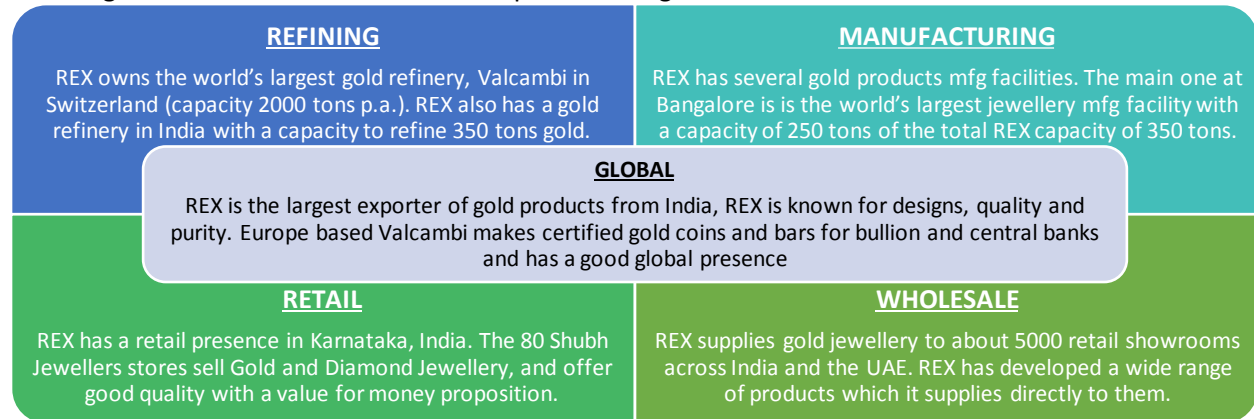


Fig 1 – REX Business Mix, Fig 2 – Gold Value Chain (Source: Company documents)



- The REX group with this acquisition now straddles across the Gold value chain. The strengths are Refining, Jewellery Manufacturing and Wholesale. The weaker spots needing investment are Mining and Retail.
- REX group installed capacities and current usage:

Activity	Capacity (Tonnes)	Actual (Tonnes)
Mining	5	1.8
Refining	2,400	1,100
Manufacturing	350	165
Export		135
Wholesale		23
Retail		7

Fig 3 – Scale of Operations, Source: Company docs

Business Notes, Recent events and Strategies

- REX has been eyeing Australian markets in a bid to secure supply of gold ore. It has made a list of interesting assets there and plans to invest up to USD \$700 million in the mining and retail sectors.
- In 2013, the RBI had mandated that 20% of all gold imported has to be exported as the govt. attempted to narrow the CAD in the country. This restricted business for REX. This rule is now being eased up.
- REX's main focus going forward would be to grow revenues, for which they will give a major push, both in retail and eCommerce space. The retail plan is to expand Shubh to 500 stores over 3-4 years globally.
- An eCommerce project for selling gold bars and jewellery globally is another high potential initiative.

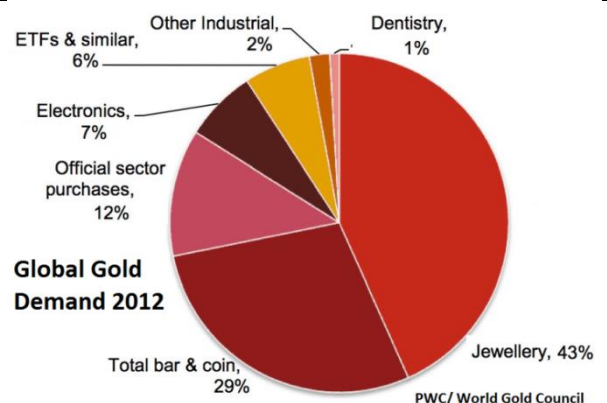
- REX has won several big orders recentl from UAE, Singapore and the European market via Valcambi.
- It has a strategic alliance with an Australian govt. owned gold mining and refining company.
- REX will form a new division for foraying into the gold finance business while using its existing network of 81 showrooms for this. This is a high margin business dominated by Muthoot Finance, Manappuram Finance and various banks which lend against gold as a security.

Indian Gems and Jewellery Industry

- Annually about 2,900 tons of gold is mined globally and about 4,000 tons of gold consumed annually. The difference is accounted for by recycled gold.

- The demand drivers are as indicated in Fig 4.
- The jewellery market in India is expected to grow at a 16% CAGR over the period 2014-19.
- The two major sectors of the industry in India comprised gold jewellery and diamonds. India is the largest consumer of gold with 20% of world consumption. Gold jewellery forms 80% of the jewellery market, and balance is studded jewellery with diamond and gemstones.

Fig 4 – Global Gold Consumption in 2012



- The Gems and Jewellery (G&J) sector plays a significant role in the Indian economy, contributing 6-7% of GDP. It is a fast growing sector, domestic and export-oriented and labor-intensive. The govt. declared the sector as a focus area for export promotion, based on its potential for growth and value-addition.
- India's G&J industry is expected to grow and reach Rs. 5-5.3 lakh cr (USD 73-78 billion) by 2018.
- India's G&J industry is highly unorganized and fragmented with 96% of the total players being family-owned businesses. The gold processing industry has around 15,000 players, with only 80 enjoying revenues over Rs 32.5 cr. India is also home to around 450,000 goldsmiths, 100,000 gold jewelers, 6,000 diamond processing players and 8,000 diamond jewelers.
- The Govt. of India is planning to establish a special zone with tax benefits for diamond import-export in Mumbai. The current top diamond trading hubs globally are Antwerp and Dubai.
- Smuggling continues unabated because of an import duty of 10% in India.

Stock evaluation, Performance and Returns

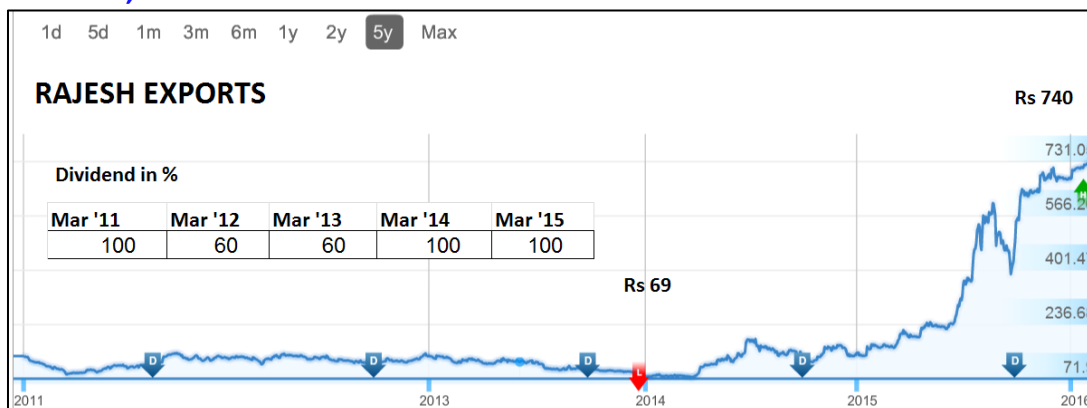


Fig 5 - Price History (JainMatrix Investments)

- The price and dividend history is detailed in Fig 5. Investors in REX over the 5 years have seen a return on 42% CAGR on the share price. In the last 1 year, the share has appreciated by 3.5X.
- The recent high of Rs 740 is just 2.7% above today's closing price.
- The Revenues, EBITDA and Profits of REX are up by 26.5%, 31.8% and 39.9% CAGR over 6 years.
- REX has EBITDA and net profit margins of 2.51% and 1.30% respectively, which are low. The current business of refining and job based jewellery mfg. are low margin, high volume businesses.
- Current P/E is 20.7 times, trailing twelve months earnings, while the Price/ Book is 6.3 times.
- Debt equity ratio is 1.14 (FY15) which is moderate. Also the dividend yield is 0.14% which is low. But management is using cash to invest in high growth business opportunities.
- REX's quarterly revenue and margins (Fig 6) indicate robust revenue growth. The March quarters are highlighted as they are the biggest by revenue. REX has maintained margins even with revenue growth.
- The Valcambi acquisition with a big revenue jump kicks in from Q2FY15. Consolidated margins have fallen immediately as they are very thin for Valcambi.

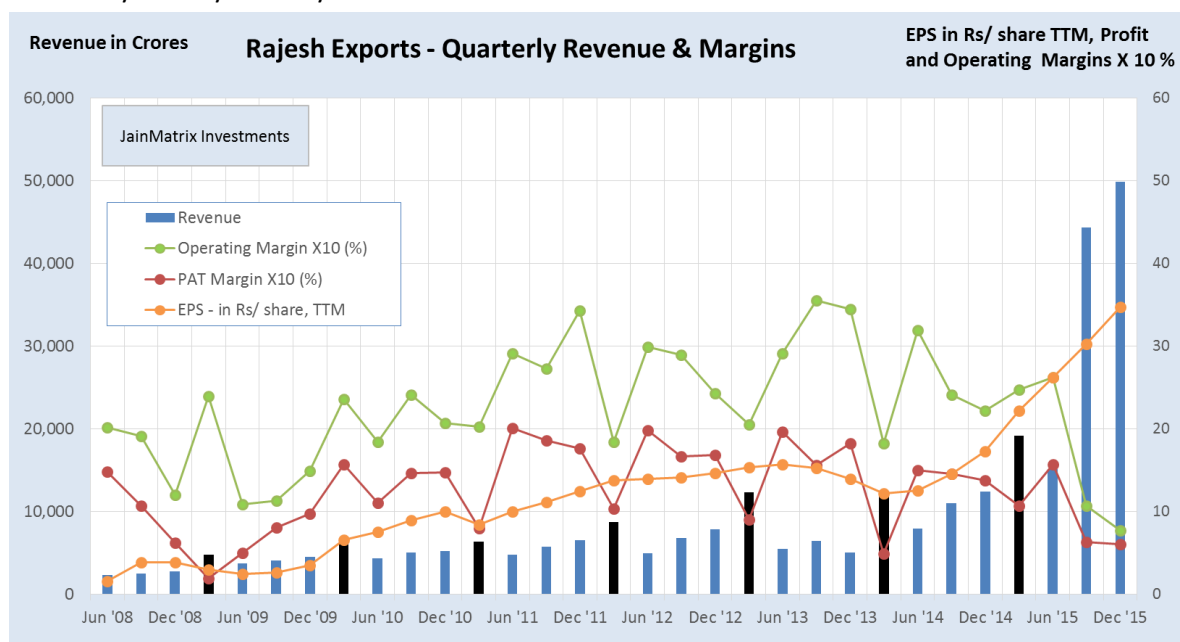


Fig 6 - Quarterly Financial

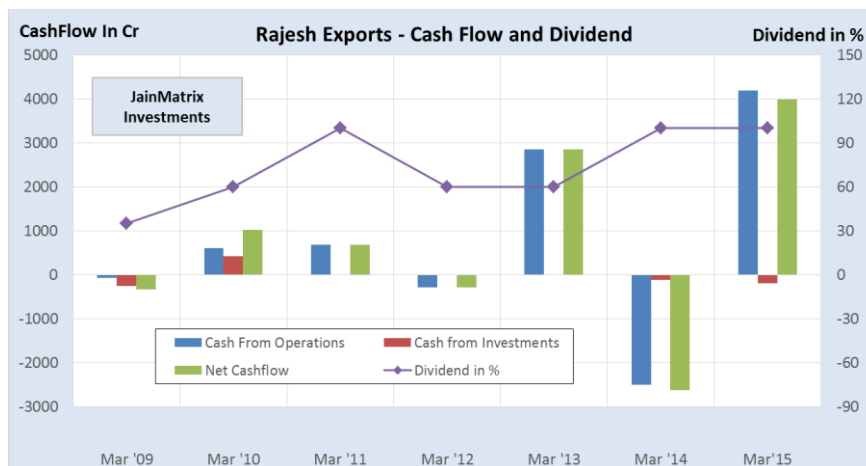


Fig 7 - Cash Flow and Dividend

- The cash flows (Fig 7) give a financial snapshot. In FY14 REX has invested into its subsidiaries in order to grow international business. REX had good free cash flows in FY15, and this is likely to continue for FY16.
- The Price and PE chart Fig 8 shows there has been a big rally in share price in the last 10 months.
- The 7 year historical average of PE is 13.75 times, and the PE range is 5.0 - 22.5 times. We can see that REX is now in the expensive quadrant. However we feel that the REX share is due for a re-rating.
- Beta of the stock is 0.51 (Reuters) indicating moderate volatility. Thus it's a stable stock.

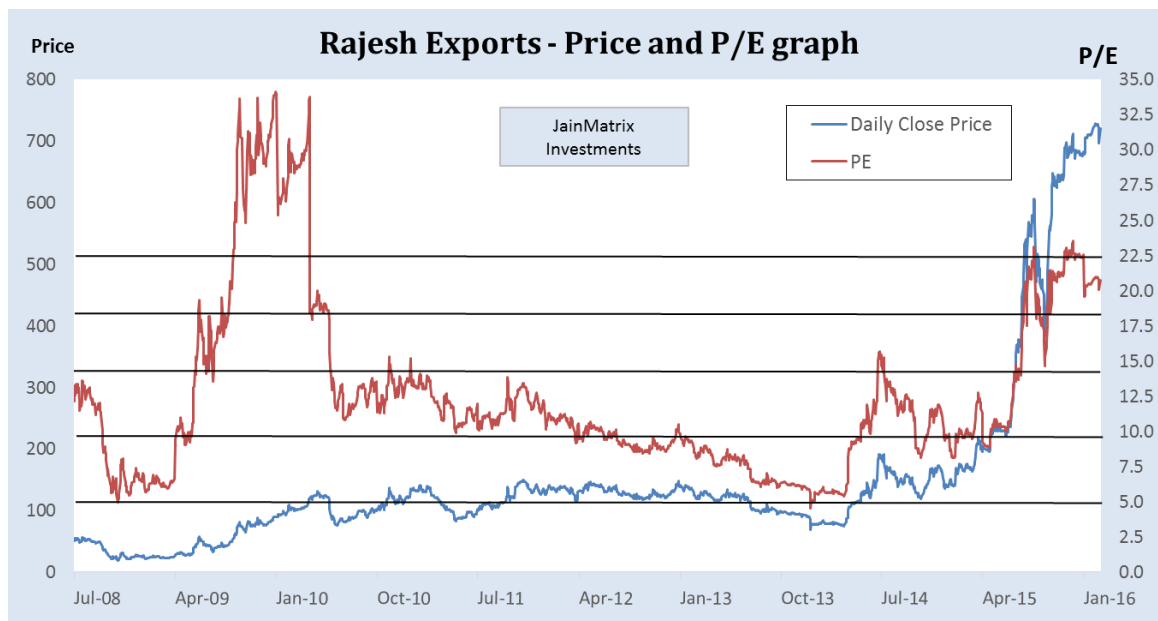
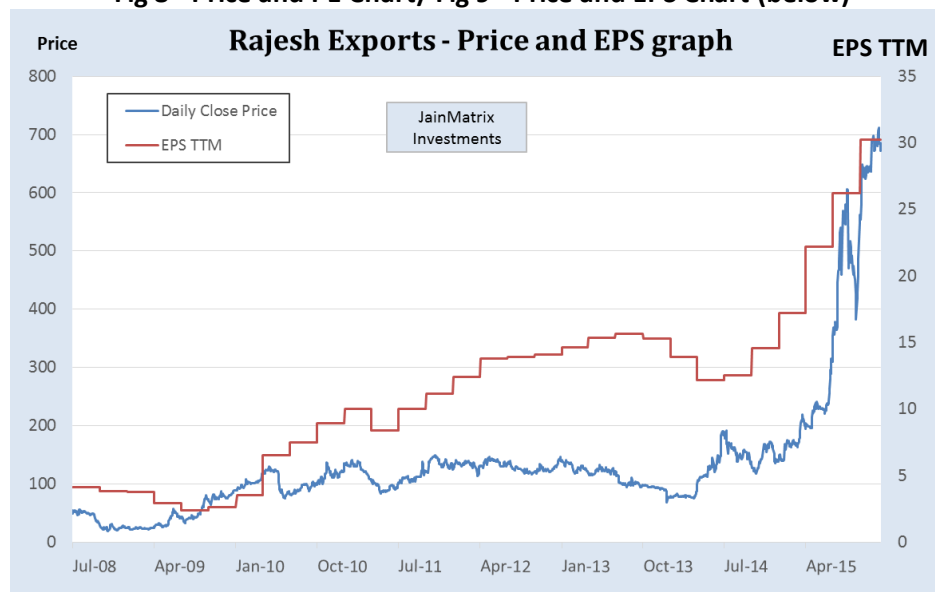


Fig 8 - Price and PE Chart/ Fig 9 - Price and EPS Chart (below)



- In Fig 10, financial metrics, we can see that the debt equity ratio of REX is moderate and has remained flattish in the last 3 years post consolidation of its business.
- The inventory turnover ratio has improved in the last 3 years.
- The interest coverage ratio has dropped in the last 3 years, and it is at low levels.
- Operating profit margins and net profit margins have decreased in the last three years.

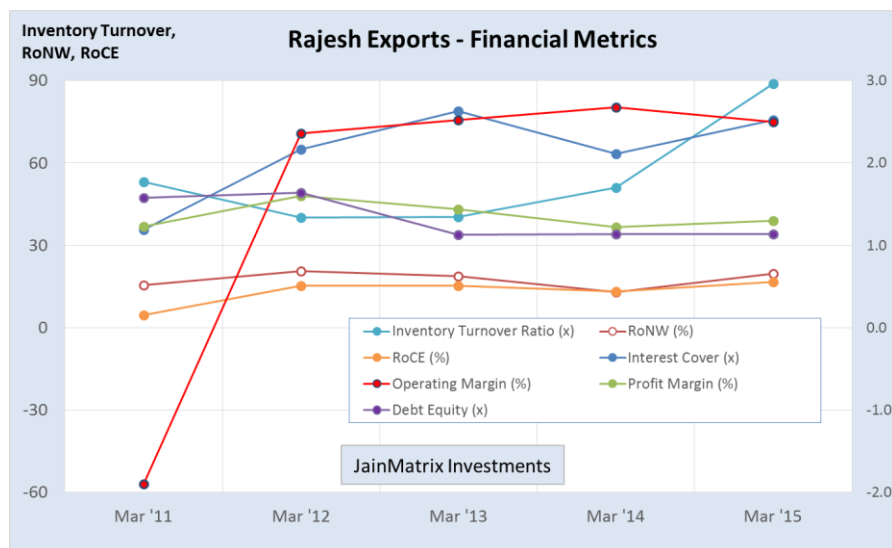


Fig 10 – Financial Metrics

Benchmarking

- In benchmarking, we compared REX with firms like PC Jewellers, Gitanjali Gems and Titan. See Exhibit 11.

Particulars	Rajesh Exports	PC Jewellers	Gitanjali Gems	Titan	Asian Star Co	TBZ
Sales (Rs. in Cr.) FY15	50,463	6,361	11,481	11,913	3,221	1,934
Net Profit (Rs. in Cr.)	655	369	158	819	77	18
Market Cap- crores	21,328	6,895	353	31,410	1,120	382
PE (x)	20.83	19.72	1.83	40.97	14.79	23.1
Price to Book Value (x)	6.35	3.54	0.08	10.33	1.78	0.83
Dividend Yield (%)	0.14	0.81	0	0.64	0.21	1.73
EBITDA Margin (%)	2.51	12.41	9.65	10.23	4.57	5.34
Net Profit Margin (%)	1.3	5.95	0.83	6.85	2.54	1.26
3 Yr CAGR Sales (%)	13.91	27.88	-2.79	10.42	20.62	11.76
3 Yr CAGR Profit (%)	17.11	16.89	-31.03	10.76	23.05	-31.62
Return on Capital Employed (%)	18.41	28.58	8.83	33.83	8.20	8.21
Return on Equity (%)	21.46	20.61	3.77	29.12	13.91	4.02
Debt to Equity Ratio (x)	1.14	0.46	2.14	0.16	1.62	1.27
Interest Coverage (x)	2.52	3.38	1.16	14	4.41	1.5
Inventory Turnover Ratio (x)	88.62	2.27	2.64	3.02	6.12	1.74

Exhibit 11 - Financial Benchmarking

- We can see that REX has high valuations, which rose after the Valcambi acquisition. The low margins are due to gold refining (a commodity business) and mostly wholesale sales of jewellery. Growth numbers have been good so far, and are expected to accelerate in FY16.
- Valcambi used to be privately held, with low disclosures. We have not made any financial projections.

Strengths and Opportunities

- As a large refiner of gold and gold jewellery, REX has the potential to dominate this sector.
- The Valcambi integration and synergy can yield cost savings, revenues and margin improvements. There is spare refining capacity at Valcambi that if utilized can boost performance. Newmont, the exiting owner, is committed to use Valcambi to refine gold from its mines for 5 years.
- The focus at REX now is on building the jewellery retail business over the next decade. Margins can improve from under 1% to 7-8% and multiply profits. The Shubh retail network can be replicated by REX globally.

- REX has one of the largest and the most advanced R&D facility in gold refining and jewellery making. The center at Bangalore has developed many proprietary jewellery making processes and designs, and has a valuable design portfolio of 29,000 active jewellery designs.
- It is the only government recognized five star export house in the jewellery sector in India.
- REX was ranked the #1 investor friendly firm by a national market survey by Business India.

Weaknesses and Risks

- M&As are fraught with many financial, integration and cultural risks. Valcambi was a privately held firm, so not enough is known about it. We will like to watch for another 2 quarters for any issues and surprises.
- Firms like Tanishq, PC Jewellers, Gitanjali Gems, TBZ, Renaissance, Thangamayil, etc. have expanded retail presence. Competition is rising in domestic G&J retail. REX is late to expand nationally with Shubh retail.
- The share has appreciated 3.5X in 1 year, this raises the price risk of share purchase at these levels.
- Gold is a commodity exposed to price fluctuations determined by demand and supply. The current global fall in commodities has not affected gold, which has actually appreciated. It is seen as a risk-off asset. See Exhibit 12 for the gold price history. REX, particularly with the integration with Valcambi, must have sound risk management systems in place to protect it from gold price fluctuations.

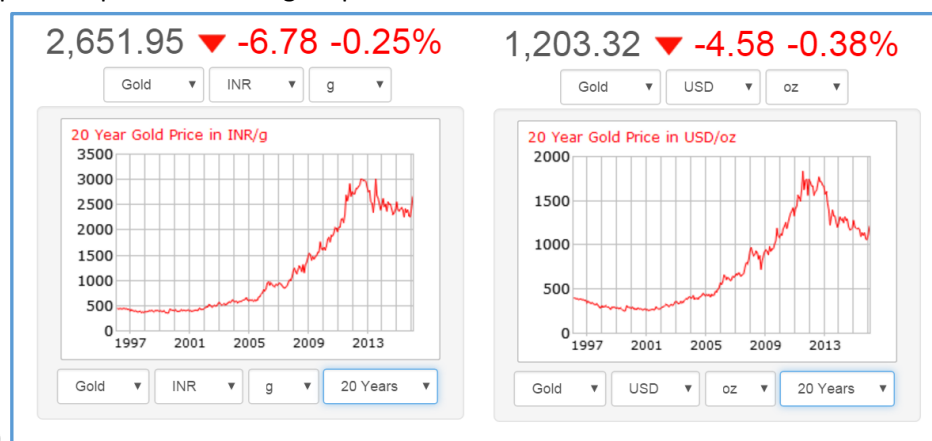


Exhibit 12 - Gold Prices (goldprice.org)

Opinion, Outlook and Recommendation

- The G&J industry in India will see high growth rates as the organized sector overtakes unorganized outlets.
- With the Valcambi acquisition, REX has expanded from the largest Indian player to a very large gold refiner and manufacturer globally. As a significant integrated player, it may be at the start of a good growth phase.
- REX has made several bold and ambitious, yet financially sound, global growth moves to reach this position. The future plans shared also appear both achievable and profitable, in the same vein.
- The management appears experienced, capable and shareholder friendly.
- While the current PE of 20.7 times looks expensive, the integration with Valcambi and the subsequent likely synergies may allow REX to grow rapidly and the share looks due for a re-rating.
- REX is a moderate risk, but high return kind of an investment at the current share price levels.
- Buy REX with a 2 year perspective.

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