

## Gems & Jewellery Sector: Insights & Prospects

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### Overview

Gems & Jewellery (G&J) industry has acquired prominence over the years in the country, given its dual utility of improving aesthetics as well as investment. The sector employs over 2.5 million workers and contributes to 6% - 7% of the Gross Domestic Product (GDP) of the country. Besides being an important foreign exchange earner. India is the largest consumer of gold besides being the largest player in diamond cutting and polishing. Accordingly, the fortunes of the companies in this sector are closely linked to the global demand supply dynamics and exchange rate changes.

The foregoing sections provide insights on the sector value chain along with an analysis of the trend in demand and supply from both global and domestic perspective.

*CARE Ratings is optimistic about growth in the domestic retail jewellery segment on back of favourable demographics, fading of regulatory headwinds such as demonetisation and GST implementation and shift in preference towards branded jewellery.*

*CARE Ratings also believes the pressure on profit margins for cut & polish diamond players would continue, given the lack lustre demand for global diamond jewellery. However, rough diamond trade volumes are expected to increase with growing significance of Mumbai in the global rough diamond trade.*

*Overall, India is expected to play a more import role in the global gems & jewellery sector, with diamond miners setting up auction centres in India and with significant investment seen in the retail end of the sector by domestic players, foreign players and private equity investors.*

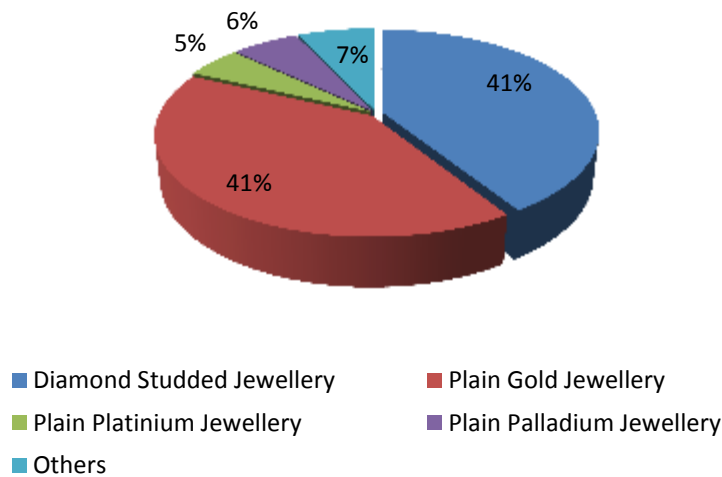
**Global Gems & Jewellery Sector Overview:**

The gems & jewellery market comprises the following segments:

- diamond studded jewellery,
- gold jewellery
- silver jewellery and
- precious and semi-precious gemstones and its jewellery.

United States (US) and Japan primarily are markets for diamond studded jewellery, while China, India, Turkey and Middle East have traditionally displayed preference for gold jewellery, although the demand for diamond studded jewellery from these markets too have grown over the last decade.

*Chart 1: Global Jewellery Demand Mix*



*Source: Industry estimates and CARE Ratings*

The global gems and jewellery demand witnessed moderation in 2015 after exhibiting growth from 2012 to 2014. In 2015, global diamond studded jewellery demand was ~USD 79 billion after touching a high of ~USD 81 billion in 2014. The sluggishness in diamond studded jewellery demand continued even in 2016 with some improvement in the intermediate quarters of the year, but again dipped in Q1 2017. The year 2016 also saw a seven year low in global demand for gold jewellery. The global gold jewellery demand in 2016 was ~2040 tonnes compared with ~2400 tonnes in 2015, a drop of ~15% y-o-y.

Strong demand by middle-class buyers has spurred growth in the mainstream jewellery retail segment and it was the main contributor to an increase in US diamond jewellery sales over the last few years. High-end jewellery retailers did not see similar growth in demand from more affluent buyers.

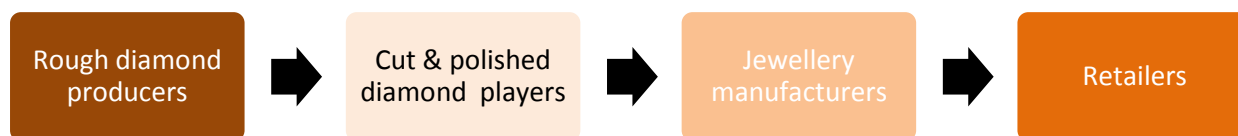
US by far, is the largest market for diamond studded jewellery accounting for over 40% of the global market. Generally, higher real income levels in US translates into higher demand for personal consumption items such as diamond jewellery and watches. Also increase in net worth has had a positive effect in the past on personal spending pattern especially on luxury items like diamond jewellery and watches. With rise in housing prices in the US and rise in stocks markets, the household net worth has seen a positive traction in 2016 and Q1 2017. Further decline in unemployment rate means higher job security which should lead to rise in personal consumption of the middle class buyers in US. However, a shift in personal spending pattern of the current generation more towards experiences, such as travel and holidays as against high value possessions may have reduced the extent of positive correlation between rise in income levels and rise in net worth vis-à-vis increase in diamond jewellery demand. In Q1 2017, the consumer demand in US was lower than expected by the retailers and which weighed in on the overall global jewellery demand.

China continues to be an important jewellery market (for both gold jewellery and diamond studded jewellery) on back of its large population and rising middle class. Also the purchases from unaccounted money was another driving factor. Gold jewellery demand from China (including Hong Kong) constitutes ~37% of the total gold jewellery demand. However, the jewellery demand growth rates in near to medium term may see a slowdown on back of the anti-corruption measures taken by the government in China, which has resulted in lower spending coupled with decline in the GDP growth rate of the country. Further, stricter travel norms and tighter control over gambling had redirected tourists away from Hong Kong and Macau to Europe and Japan. This resulted in lower demand from the tourists and contraction in the Hong Kong and Macau market for diamond studded jewellery in 2015. The sluggishness in demand for diamond studded jewellery continued through 2016 and Q1 2017. Gold jewellery consumption also exhibited a decline in China from peak levels in 2013. China's gold jewellery consumption (as per World Gold Council data) exhibited a ~17% decline (in volume terms) in 2016 over 2015. In 2015 too, the demand (in volume terms) had been lower by ~6% over the previous year.

Europe and Japan showed some improvement in demand for diamond studded jewellery in local currency terms in 2015; however the same slowed down from Europe after Brexit

India is relatively smaller market for diamond studded jewellery with only ~7% market share. However it is a key market for gold jewellery and constitutes ~27% of the global gold jewellery market. While gold jewellery demand (in volume terms) from India saw an improvement by ~5% y-o-y in 2015, the same exhibited a decline by ~24% y-o-y in 2016. An initial rush for gold following the policy announcement came to a swift halt in the ensuing cash crunch post demonetisation.

### Diamond Jewellery Value Chain

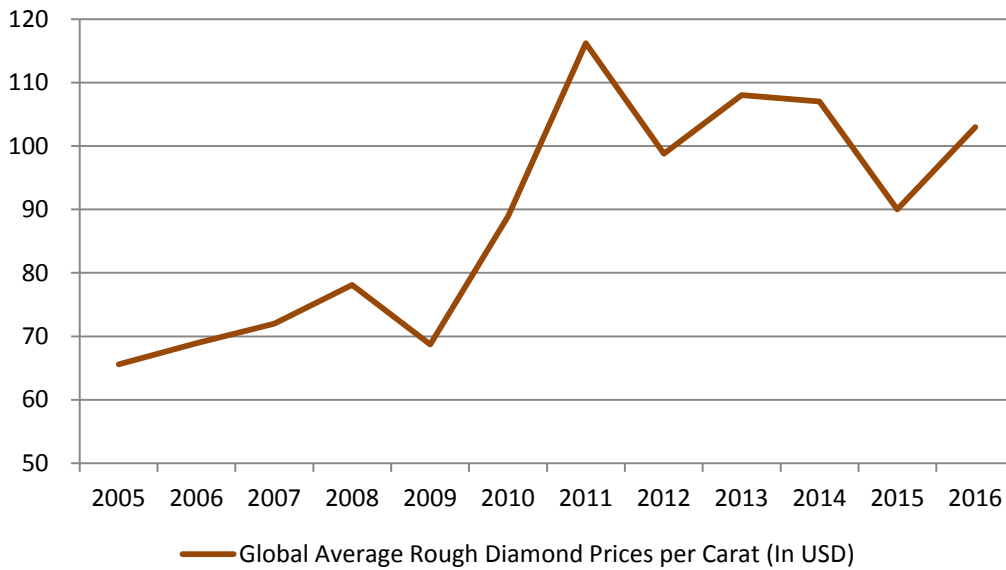


ALROSA, De Beers, Rio Tinto, Dominion Diamonds, Petro Diamonds are the top producers of rough diamond in the world which constitute close to ~67% of the rough diamond production. Other mining companies constitute remaining 33% of the mine production. Given the large investment requirement for diamond mining coupled with lack of any new mines available for sale to new players and requirement of regulatory approvals, there exists a very high entry barrier at this end of the value chain and thus high bargaining power exists with the rough diamond miners/ producers.

In 2016, the mine production (in volume terms) of the large diamond mining companies (primarily ALROSA and De Beers) saw a marginal dip; although sales (in value terms) saw improvement on back of restocking of inventories by the midstream players and increase in rough diamond prices, post a dip in late 2015. Rough diamond sales had declined in 2015 with midstream players reducing their inventory levels and cutting back on new orders for rough diamonds amidst sluggish demand for polished diamonds and high rough diamond prices in early part of the year. In late 2015, rough diamond prices exhibited a decline.

Global diamond production in 2016 was ~128 million carats as against ~127 million carats in 2015. Global diamond production has remained between 125 million carat and 130 million carat levels since 2009 after dropping from a peak of ~163 million carat levels in 2008. Supply levels have been maintained on back of growth in production from mines in Australia, while there has been a sharp decline in production from mines in Zimbabwe and Botswana. In 2017, the production for the top two players (i.e. ALROSA and De Beers) is expected to be back to 2015 levels while Rio Tinto would continue to increase its mine production. **Accordingly, we do expect global diamond mine production would touch ~140 million carats**

With significant bargaining power at the miners end, the rough diamond prices are largely determined by these companies. In 2016, despite lack-lustre demand growth, rough diamond prices exhibited an increase. Further in 2017, De Beers is expected to reduce the rough diamond allocation for sight holders, and hence there is expected to be a sense of shortage in the rough diamonds for the sight holders which may lead to an increase in rough diamond prices. Further the rough diamonds from non-sight holder mines also are expected to enter the market at a higher price. Given the high bargaining power of the diamond mining companies, these companies earn the highest operating margins (~23% to 25%) in the value chain.

*Chart 2: Trend in Average Rough Diamond Prices*

Source: Kimberley Process Statistics

Midstream segment includes producers and traders of cut & polished diamonds. India and China constitute ~90% of the combined midstream segment market share due to the low cost structures. The midstream segment is highly sensitive to price volatility and demand-supply balance of rough and polished diamonds as they can only exert limited pressure over both ends i.e., suppliers and retailers. India constitutes the major share in the midstream segment primarily on account of its cost leadership and relatively more developed diamond industry financing infrastructure, with various forms of export and import credit available. Net exports of polished diamonds from India grew at a CAGR of ~15% between 2009 & 2014 in USD terms. China's exports in this segment on the other hand grew at a CAGR of ~5% between 2009 & 2014. China occupies a solid second position in the midstream segment on back of cost efficiency and high specialization in particular stone size and shapes.

Midstream players earn the lowest operating margins in the value chain. The operating margins for midstream players had witnessed a decline in 2015 on back of higher rough prices in early part of the year corroborated with lower demand and thus lower realizations for polished diamonds. Given this scenario, midstream players were seen offloading their rough diamond inventories in late 2015 to improve their cash flows. With correction in rough diamond prices in the early part of 2016 and with restocking of rough diamond inventory at the relatively lower price levels, the operating margins saw some improvement in 2016. However with demand for polished diamonds staying sluggish, the profit margins would continue to remain under pressure in 2017. Further Indian midstream players would also see some impact on margins due to change in their inventory purchase patterns and inventory holding patterns in the current year in anticipation of the change in the indirect taxes on back of the Goods & Services Tax (GST), which was implemented in the country on July 1, 2017.

Further access to finance for this segment of the value chain remains a key challenge given the high working capital requirement levels on back of high inventory days, high receivable days, low profit margins and raw material price volatility. Also lack of corporatization and high level of group entity transactions for midstream firms have been a further deterrent for banks & financial institutions in extending credit to this segment of the value chain.

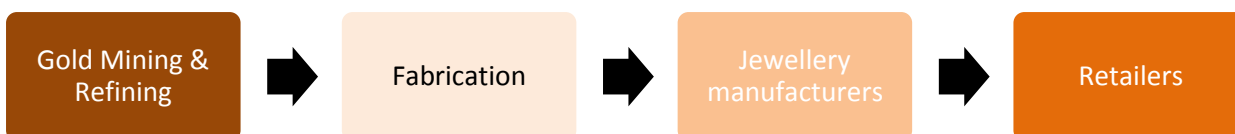
Diamond studded jewellery manufacturing is scattered across geographies with mid-to-low range jewellery being primarily manufactured in India and China, whereas high-end jewellery manufactured and sourced mostly from Europe. This segment of the value chain is less susceptible to changes in the rough diamond prices and hence the operating margins are largely stable in the range of ~3% to 5%.

Retail segment in the diamond studded jewellery sector is regional in nature with very few international brands such as Cartier and Tiffany & Co. Most others are national or regional such as Signet in US, Tanishq in India, Chow Tai Fook in China, etc. This end of the value chain has the second highest level of operating profit margins across the diamond value chain. (~ 10% - 12%).

Box 1: Synthetic diamonds/ Lab Created Diamonds:

Lab created diamonds (which are also referred to as lab grown diamonds, synthetic diamonds, artificial diamonds, cultivated diamonds or a cultured diamonds) are man-made diamonds that mirror a real, natural diamond. As they actually consist of carbon atoms structures lab created diamonds display the same chemical and optical characteristics of a natural diamond crystal produced by the geological processes of Mother Nature. Since lab diamonds possess similar optical and chemical characteristics, it is difficult to differentiate a lab grown diamond from real diamond through traditional methods. There have been instances in the past wherein lab created diamonds were mixed with real diamonds resulting in losses for the diamond midstream players. Lab created diamonds are said to be 30% - 40% cheaper than real diamonds, however there is no re-sale value for the lab created diamonds. China is the largest manufacturer of lab created diamonds followed by US. International Institute of Diamond Grading & Research (IIDGR) has invested USD 5 million for expanding its synthetic diamond testing facility in Surat to address this issue faced by the players.

Gold jewellery value chain:



Supply of gold comes from two sources: primary mining and recycled gold. Barrick Gold, Newmont Mining, AngloGold Ashanti, Gold Fields, Kinross and Goldcorp are the top miners of gold. Top four gold producers account for ~20% to 25% of the formal mined gold. Concentration of top players in case of gold is much lower than in case of rough diamond miners. In terms of reserves the top four account for ~60% of the proven and probable gold reserves. China, South Africa, Australia, Russia, Canada, etc. are the major producers of gold in the world.

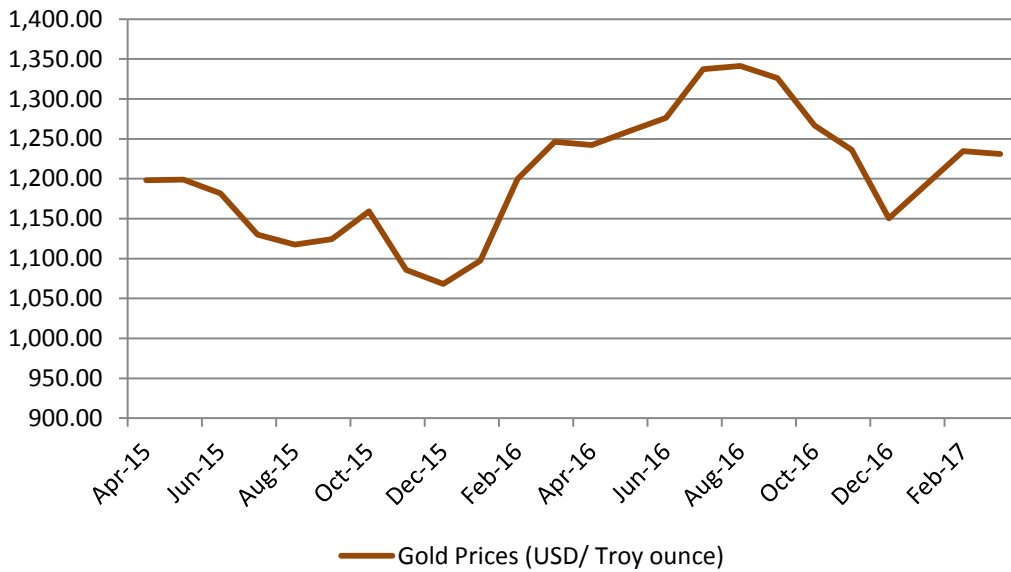
The price of gold is controlled by its demand (consumption demand and investment related demand including retail and central banks) & supply scenario and by the primary mining costs incurred by the mining companies. Nonetheless, ore quality has been a factor weighing down the gold supply for too long now as the quality is declining over a period of time, from 12 grams of gold per tonne of ore in the 1950s to about 3 grams per tonne in the last decade, making gold production less lucrative for the mining companies.

In 2016, mine production increased by only a percent to 3,255 tonnes as against 3220 tonnes in 2015. The recycled gold supply however saw a jump by ~16% from 1119 tonnes in 2015 to 1295 tonnes in 2016. This was on back of increase in average gold prices in 2016 especially in the local currency terms in both India and China (major markets for gold jewellery). The prices of gold saw a jump of ~13% in rupee terms and ~14% in renminbi terms. In dollar terms the increase in price was around ~8%.

Unlike diamonds which just requires polishing, gold requires a lot of refining process to extract the gold from the excavated ores. Pure & refined gold is fabricated into gold bars. Fabricated gold either goes for investment purpose or in the manufacturing of jewellery. Italy, China and India dominate in the gold fabrication process.

While, high-end gold jewellery designing is carried out in countries like Italy and Turkey; jewellery manufacturing is outsourced to low cost countries like India and China. India and China are the largest consumers as well as the largest manufacturers of the gold jewellery in the world. India has well-established capabilities in making hand-made ethnic jewellery, which has huge demand in countries with Indian immigrants. India has also capabilities in machine-made jewellery.

Chart 3: Trend in international gold prices



Source: CMIE

In India, gold can be imported only through authorised banks, certain agencies such as MMTC, STC, etc. and star and premier export houses. Bank of Nova Scotia has the largest share amongst the banks for import of gold. Gold has normally been imported through either of the following ways – 1) Direct import of gold through banks/agencies/ export houses, 2) Import of gold on loan basis, 3) Import of gold on unfixed price basis and 4) Import of gold on consignment basis. The Government of India’s announcement on establishing gold spot exchange could help in India’s participation in determining gold price in the international markets.

Gold jewellery in all the major markets including India, China, Turkey and Middle East has traditionally been sold by unorganised local jewellers. While there has been a shift towards branded jewellery, the market is still largely comprises regional players with a few national retailers but no major international retailer.

**Indian Gems & Jewellery Sector Overview:**

Indian Gems & Jewellery (G&J) industry has acquired prominence over the years in the country, given its dual utility of improving aesthetics as well as investment. Today, India is the largest consumer of gold as well as the largest player in diamond cutting and polishing. A major chunk of gold jewellery manufactured in India is for domestic consumption, whereas a major portion of polished diamonds or finished diamond jewellery is exported.

Demand for gold is well distributed across the country and states like Kerala, Maharashtra, Gujarat and Uttar Pradesh are some of the major demand centers. The southern states like Kerala, Andhra Pradesh, Tamil Nadu and Karnataka account for ~37% of the country’s total gold demand, which is followed by the western region with ~32%, northern region ~18%



and eastern region ~13%. The demand for diamond studded jewellery in India remains higher in the western and northern regions as compared with the south and eastern region which are predominantly gold jewellery consuming markets. In order to protect consumers from adulteration and sub-standard metal quality, the government had launched the Hallmarking Scheme through the Bureau of Indian Standards (BIS). Currently, there are about 185 BIS-recognised assaying and hallmarking centres in India, primarily in Tier-1 and Tier-2 cities.

The sector provides employment to over 2.5 million and is home to more than 500,000 players, with the majority being small players. The sector contributes 6% - 7% to the Gross Domestic Product (GDP) of the country. Based on the potential for growth, the gems & jewellery industry has been declared as focus area for export promotion. India is the largest exporter of gems and jewellery and industry plays a vital role in terms of foreign exchange earnings. UAE, US, Russia, Singapore, Hong Kong, Latin America and China are the biggest importers of Indian jewellery.

To address the issue of shortage of skilled manpower, the Gems and Jewellery Skill Council of India is planning to train over four million people till 2022 through tie-up with Gemmological Institute of America (GIA) and Indian Gemmological Institute (IGI), along with setting up of new institutes in major diamond cutting and processing centres.

The Indian government presently allows 100% Foreign Direct Investment (FDI) in the sector through the automatic route. As per Department of Industrial Policy and Promotion (DIPP), the cumulative FDI inflows in the diamond and gold jewellery sector in the period between April 2000 and September 2016 was USD 851.34 million.

In FY17, the total exports under the gems and jewellery sector was ~USD 35.5 billion as compared with ~USD 32.6 billion in FY16 a growth of ~8% y-o-y. In rupee terms the total exports was reported at Rs.2.38 lakh crore in FY17 as against Rs.2.14 lakh crore in FY16, a growth of ~11% y-o-y. In FY16, the industry had witnessed a drop in exports by ~12% y-o-y, on back of lower global demand for luxury product.

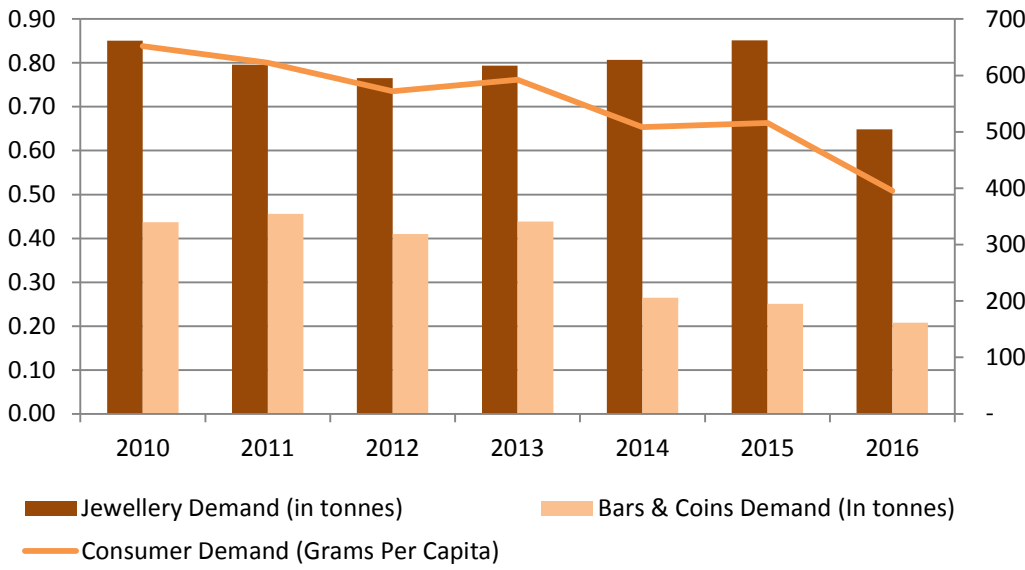
Despite India being a leading player in the global gems & jewellery sector, the current penetration of organized segment in India remains quite low. The contribution of national level players such as Gitanjali, Tanishq, Reliance Jewels, etc., is mere 6% - 8% of total gems & jewellery industry in India, whereas if we further include regional jewellery retail chains like Kalyan Jewellers, Malabar Gold, PC Jewellers, TBZ, GRT Jewellers, P N Gadgil, Thangamayil Jewellery, etc. the contribution from organized sector rises to 16% -18%. However, the industry has witnessed emergence of many new players and expansion of existing players in the organized market in the recent past. Going ahead, the penetration of organized gems & jewellery market is expected to increase due to changing lifestyle patterns and mall culture fast catching-up in Tier-II & Tier-III cities.

Consumers have become more informed about the quality and certification of gold jewellery and are now insisting for certification. The Indian Diamond Institute (IDI - Surat), Gemmological Institute of India (GII - Mumbai) and The Gemmological India Enterprise (GIE - New Delhi) have been the Indian institutes for certifications. Off late, the jewellery retailers and traders have also started testing their polished stones with foreign laboratories like Gemmological Institute of America (GIA), International Gemmological Institute (IGI).

### **Domestic Consumption:**

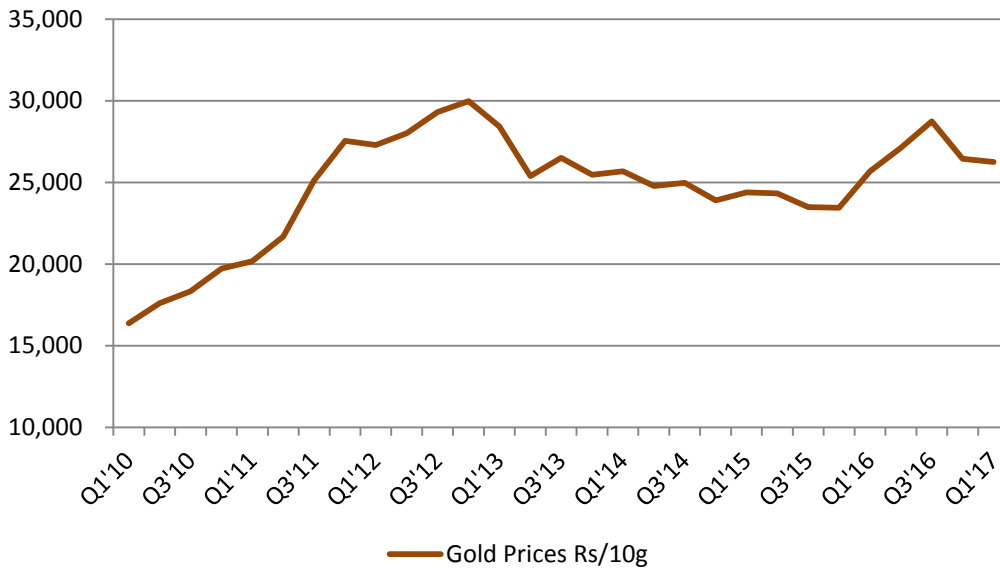
Domestic consumer demand for gold saw a decline of ~22% in 2016 to ~666 tonnes as against ~857 tonnes in 2015. The gold jewellery demand was at ~505 tonnes and demand for bars and coins was at ~162 tonnes in 2016. The drop in demand was more pronounced in case of gold jewellery, wherein there was a ~24% drop reported in 2016 over 2015. The bars and coins demand dropped by ~17% in 2016 over the previous year. The drop in demand can be mainly attributed to jewellers strike in the early part of the year on account of 1% excise duty which was levied on jewellery manufacturing and PAN card requirement for gold purchases above Rs.2 lakh. Further, the rural community was the hardest hit by cash crunch on account of demonetization which led to decline in gold demand in last quarter of 2016. There was also some shift towards sovereign gold bonds scheme, which was introduced in November 2015. The first quarter of 2017, however saw some revival with a 15% growth y-o-y primarily driven by jewellery demand. Factors such as monsoon, growth in rural income, gold and diamond prices and implementation of GST (with levy of 3% on precious metals and precious jewellery) would determine the domestic demand in 2017. Going forward, favourable demographics and improved consumer sentiment coupled with increased in availability of gold and expansion of retail network by organized players would lead to 5% - 6% growth in the gold jewellery demand in volume terms over the medium term to long term. However, it would be interesting to note that the per capita consumption of gold (in terms of grams per capita) has been reducing continuously overtime with increase in gold prices and with shift in preference of the current generation towards other avenues of investments as against gold.

Chart 4: Trend in Consumer Demand for Gold in India



Source: World Gold Council

Chart 5: Trend in Gold Price in India



Source: World Gold Council

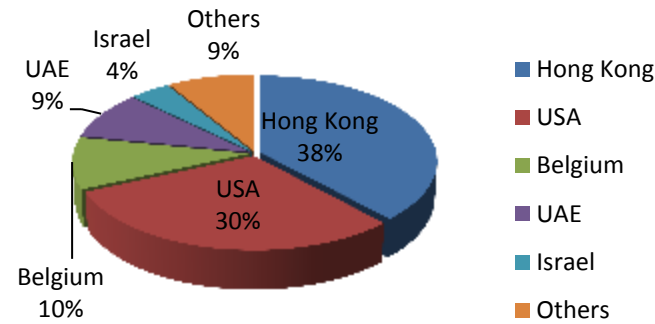
**Exports from India:**

Cut and polish diamond export constituted ~53% of the total gems & jewellery exports in value terms in FY17. Rough diamond exports formed ~3% of the total export value. In FY17, the total value of diamond exports grew by ~15% to ~Rs.1640 billion. (In USD terms, however the y-o-y growth in FY17 was at ~12%) For the previous two years, the diamond exports in rupee terms had exhibited a drop of ~6% and drop of ~4% in FY16 and FY15, respectively. In terms of carats, the

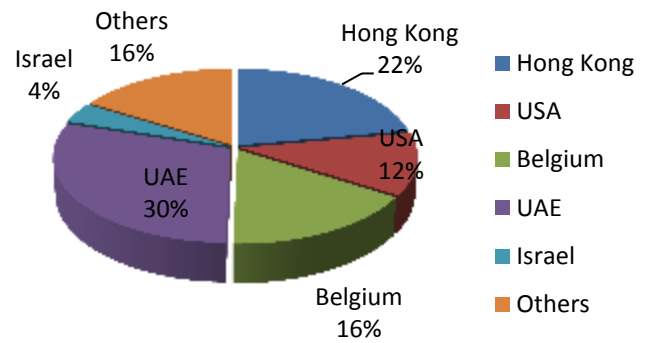
diamond export growth in FY17 was much lower at ~3%. In the previous two years the diamond export in carat terms had exhibited a drop of ~8% and drop of ~11% in FY16 and FY15, respectively. Hong Kong continued to be the largest export destination, followed by USA. Belgium and UAE were other important export destinations in FY17.

Chart 6: Share of Major Polish Diamond Export Destination in Value and Carat:

Share in terms of value

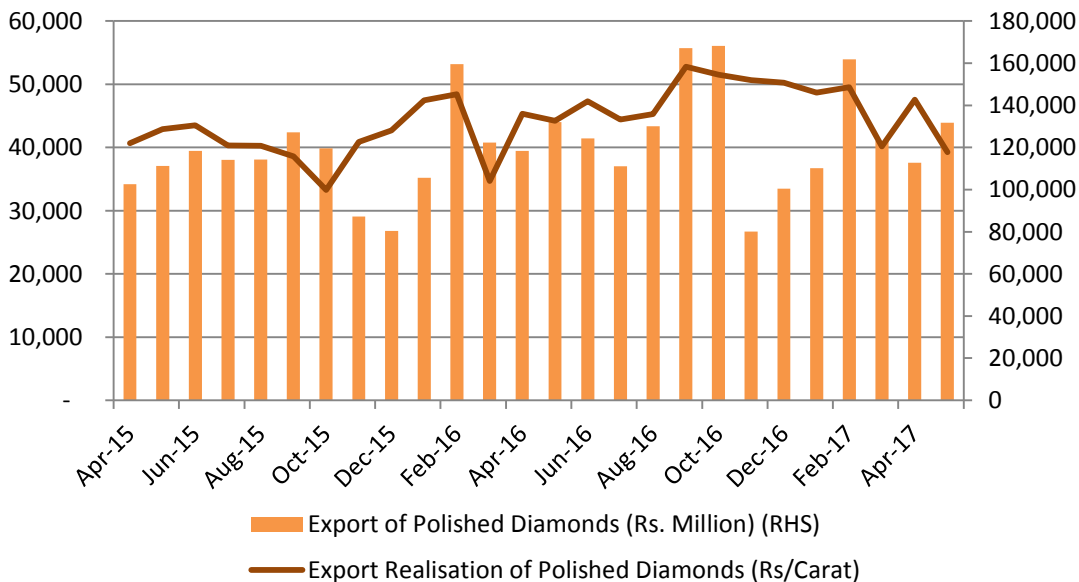


Share in terms of carat



Source: CMIE

Chart 7: Trend in Polished Diamond Exports and Realisations:



Source: CMIE

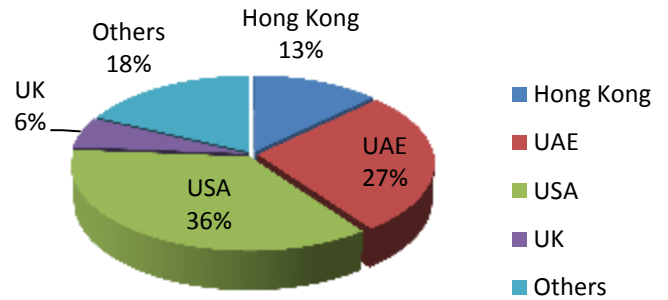
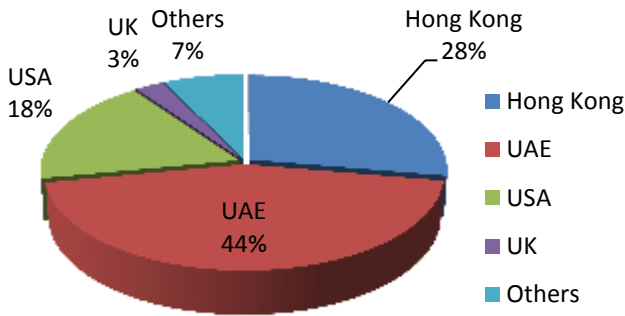
The jewellery exports constituted ~28% of the total value of total gems & jewellery exports from India. Of this gold based jewellery formed ~19% and silver based jewellery formed ~9% of the total export value.

In FY17, the total jewellery exports in rupee terms exhibited a growth of 13% over the previous year to ~Rs.800 billion. This was on back of ~11% y-o-y drop in FY16 and ~23% y-o-y growth in FY15. (In USD terms, the y-o-y growth was ~10% in FY17). The growth was primarily led by increase in gold prices especially in local currency terms. In terms of volumes, the jewellery exports growth was much lower at ~3% y-o-y in FY17. This was on back of flat jewellery export volumes in the previous year and ~11% y-o-y growth in jewellery export volumes in FY15. UAE was the largest export destination in value terms followed by Hong Kong, while US was the largest export destination in terms of volume. This is because of the product mix difference in the exports to US, as compared to UAE and Hong Kong. UK was the other major jewellery export destination.

Chart 8: Share of Major Jewellery Export Destination in Value and Volumes (in tonnes):

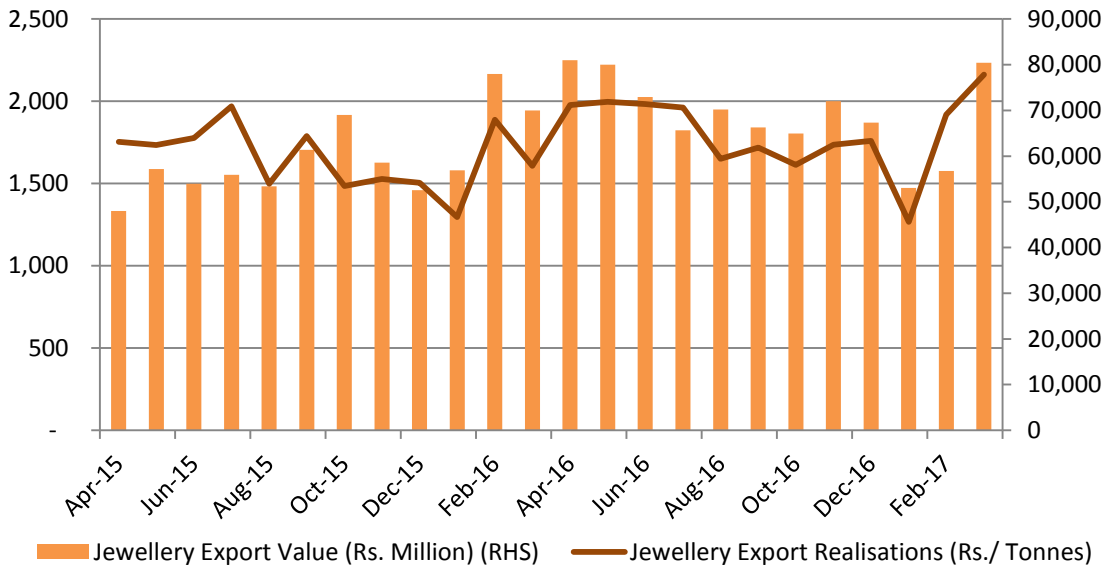
Share in terms of value

Share in terms of volume



Source: CMIE

Chart 9: Trend in Jewellery Exports and Realisations:



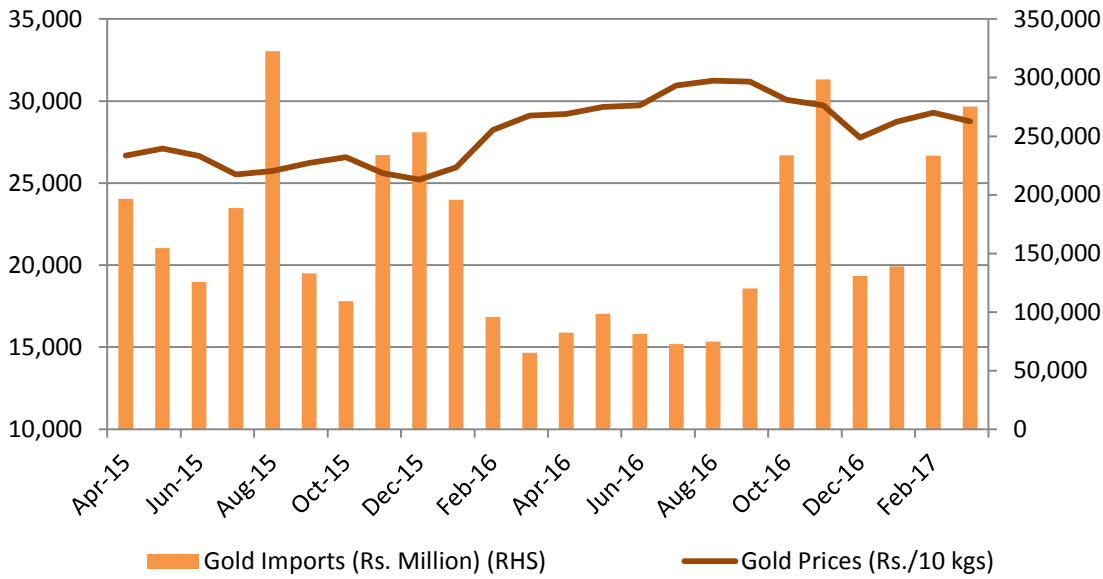
Source: CMIE

Over the last two years the country has also seen some jump in exports of gold coins and medallion. In FY17, the gold coin and medallion exports in rupee terms amounted to ~Rs.356 billion. In the previous year the same was at ~Rs.288 billion.

**Imports into India:**

India is the largest consumer of gold, however the production of gold in India has been in the range of 2-4 tonnes and hence almost the entire gold consumed in India is imported. In FY17, the gold import in rupee terms dropped by ~11% y-o-y at ~Rs.1844 billion. (In USD terms the drop was more pronounced at ~14% y-o-y in FY17). In FY16, gold imports in rupee terms had seen a drop of 1.5% y-o-y. In terms of volume, gold imports in FY17 dropped by ~19% y-o-y. In the previous year gold imports in volume terms had exhibited ~6% growth. Most of the gold imports into India were sourced through Switzerland followed by UAE.

Chart 10: Trend in Gold Imports and Prices:



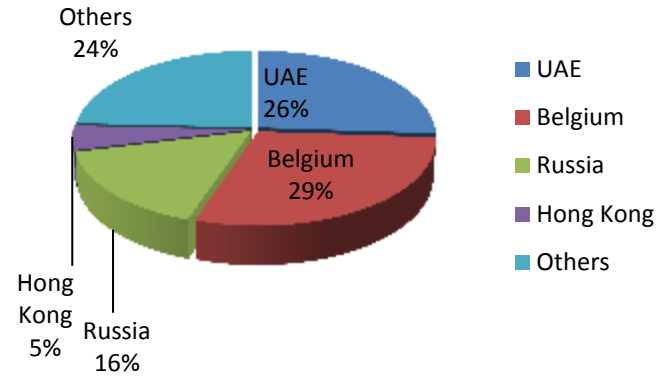
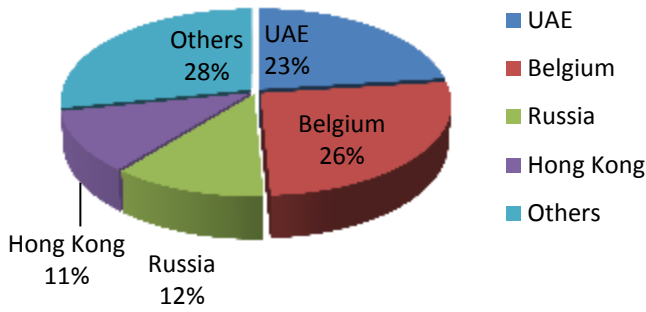
Source: CMIE

The total value of diamond imports grew by ~17% to ~Rs.1300 billion. The growth came on back of increase in rough diamond prices, increase in polished diamond exports and restocking of the reduced diamond inventory levels by midstream players seen in the previous year. In the previous two years, the diamond imports in rupee terms had exhibited a drop of ~12% and a drop of ~7% in FY16 and FY15, respectively. In terms of carats, the diamond imports also grew at much lower rate of ~5%. While, Belgium continued to be the key sourcing hub for diamond imports, its share saw a significant decline in FY17. Belgium’s share decline from ~39% of the total value of diamond imports in FY16 to ~26% of the total value of diamond import in FY17. UAE and Russia were two other important sourcing hubs, with Russia gaining importance in terms of share in FY17 over the previous year. In light of the shift in source, India has recently signed a memorandum of understanding (MoU) with Russia to source data on diamond trade between the two countries. In future, India plans to establish a special zone with tax benefits for diamond import and trading in Mumbai, in an effort to develop the city as a competitor to Antwerp and Dubai which are currently the top trading hubs for diamonds.

Chart 11: Share of Major Rough Diamond Import Hubs in terms of Value and Carat:

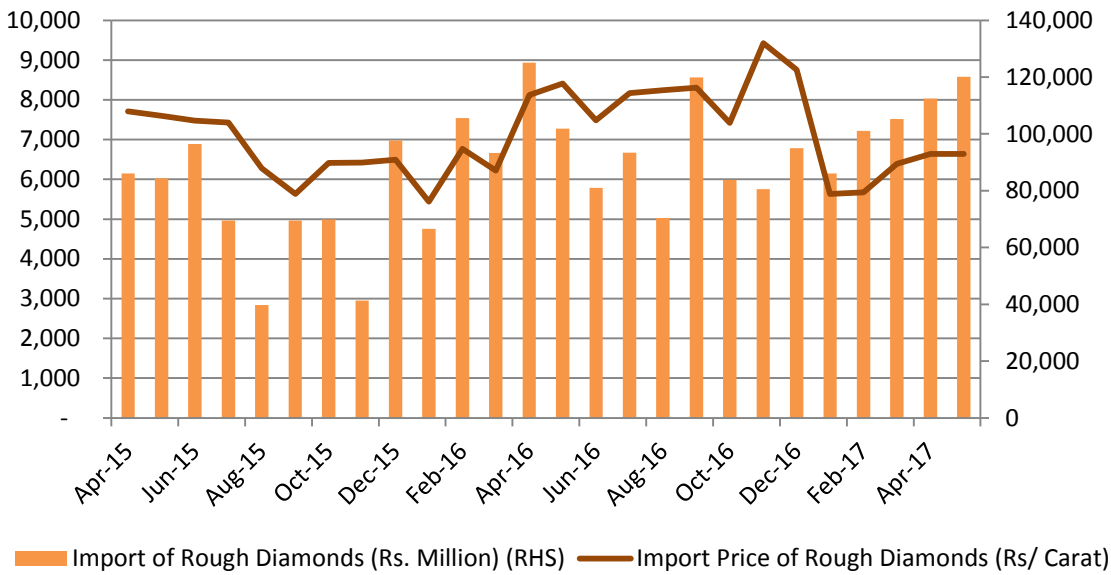
Share in terms of value

Share in terms of carat



Source: CMIE

Chart 12: Trend in Rough Diamond Imports and Prices:



Source: CMIE



The jewellery imports have been relatively insignificant as compared to jewellery exports and further seen a declining trend. In FY17, jewellery imports in rupee terms amounted to ~Rs.22 billion.

### **Government Regulations and Policies:**

Given the high value of the transactions and foreign exchange involvement, on account of large amount of diamond and gold imports, the gems & jewellery sector can be susceptible to misuse and money laundering. It is hence imperative for the government and RBI to keep a check on the sector to ensure legitimacy of the transactions and restrict large speculative transactions which may compromise the stability of the Indian currency.

### **Box 2: Chronology of Government Policies and Regulations**

- January 21, 2013: Government of India increased import duty on gold and platinum from 4% to 6%
- May 13, 2013: RBI restricted the import of gold on consignment basis
- May 27, 2013: RBI prohibited advances granted by NBFCs for the purchase of gold in any form, including primary gold, gold bullion, gold jewellery, gold coins, units of gold Exchange Traded Funds (ETF) and units of gold mutual funds
- June 4, 2013:
- GoI increased the import duty on gold and platinum from 6% to 8%
- RBI directed that all Letters of Credit (LC) to be opened by Nominated Banks/Agencies for the import of gold under all categories will be only on 100% cash margin basis
- July 22, 2013:
- Guidelines issued in May and June 2013 were withdrawn
- Introduction of 20/80 scheme: It was directed that nominated banks/agencies to ensure 20% of imported quantity of gold to be made available for exporters.
- RBI also asked banks and credit card companies to discontinue the EMI option for online jewellery purchase.
- August 13, 2013: GoI increased the import duty on gold and platinum from 8% to 10%
- August 14, 2013
- RBI again prohibited Gold-on-lease after withdrawing the ban in July 2013
- Prohibition of imports of gold coins and medallions
- Further, it was directed that, gold will be made available to only jewellers/bullion dealers/banks involved in gold deposit scheme after upfront payment of cash
- September 18, 2013: GoI increased the import duty on gold jewellery from 10% to 15%.
- March 19, 2014: RBI eased gold import norms by allowing five domestic private banks – HDFC Bank,

Axis Bank, Kotak Mahindra Bank, Indusind Bank and YES Bank to import gold in the country.

- April 1, 2014: RBI lifted restrictions on a number of mines abroad, to which advance remittances can be extended for imports of rough diamonds. Banks were allowed to have their own discretion to extend advance remittance to Indian importers in favour of global miners.
- May 21, 2014: RBI further eased gold import norms by allowing Star trading houses/premier trading houses (STH/PTH), registered as nominated agencies by the Director General of Foreign Trade (DGFT), to import gold under 20/80 scheme.
- May 21, 2014: G&J players were allowed to avail Gold Metal Loan (GML), thereby enabling procurement of gold on lease basis.
- November 28, 2014: Withdrawal of the 80/20 import rule
- Feb 18, 2015: RBI lifts ban on import of gold coins, medallions by banks & trading houses. RBI allowed banks to give gold on loan to jewellers.
- September 15, 2015: RBI introduces gold monetization scheme.
- January 01, 2016: The central government has made it a must to quote the permanent account number (PAN) for all transactions above Rs.2 lakh.
- April 01, 2016: The government imposes 1% of excise duty on jewellery manufacturing.
- July 01, 2017: GST rate of 3% applied to gold and precious metals.

### **Investment and Recent Developments in the Sector:**

#### *Retailing*

- India arm of US private equity (PE) firm Warburg Pincus picked up a minority stake in Kerala-based Kalyan Jewellers for ~Rs.1,200 crore (USD 176 million). The proceeds are expected to fund its retail and manufacturing expansion plans. Kalyan Jewellers has plans to invest ~Rs.500 crore (USD 75 million) to add 15 new showrooms in 2017, to add to their on-going expansion in Northern and Eastern regions of India as well as expansion in West Asia. Company also has plans to invest ~Rs.900 crore (USD 133.55 million) over the next three years to expand its presence in the international markets like Sri Lanka, Singapore and Malaysia.
- Joyalukkas plans to invest ~Rs.1,500 crore (USD 220.08 million) on setting up 20 stores in India and 10 overseas. The new stores are expected to come up in a year's time. This would add to the company's existing 95 outlets.
- Creador, a PE firm focused on long-term investments in growth-oriented businesses in Indonesia, India, Malaysia and Singapore, invested ~Rs.135 crore (USD 20.28 million) for a minority stake in PC Jeweller Limited.
- KSS Limited, a digital and entertainment player, has forayed into the jewellery retailing business under the franchise model and is planning to open ~500 stores under brand 'Bjewelz' which is owned by Birla Jewels Limited, a wholly owned subsidiary of KSS Limited.

- Melorra, a Bengaluru-based online jewellery start-up, has raised ~USD 5 million funding from venture capital firm Lightbox Ventures, to build its brand, enhance its technology platform, and talent acquisition.
- Global luxury brand Montblanc International has entered into a joint venture with India's largest watch maker Titan Co. Ltd. and plans to start the retail operations in India by opening five Montblanc boutiques in Mumbai, Delhi, Hyderabad and Pune.
- London's ultra-luxury jeweller for the super-rich, Faberge, owned by the world's top emeralds and rubies-miner Gemfields Plc., has decided to enter India. The jeweller plans to sell its products through select trunk shows for the uber rich in Delhi and Mumbai.

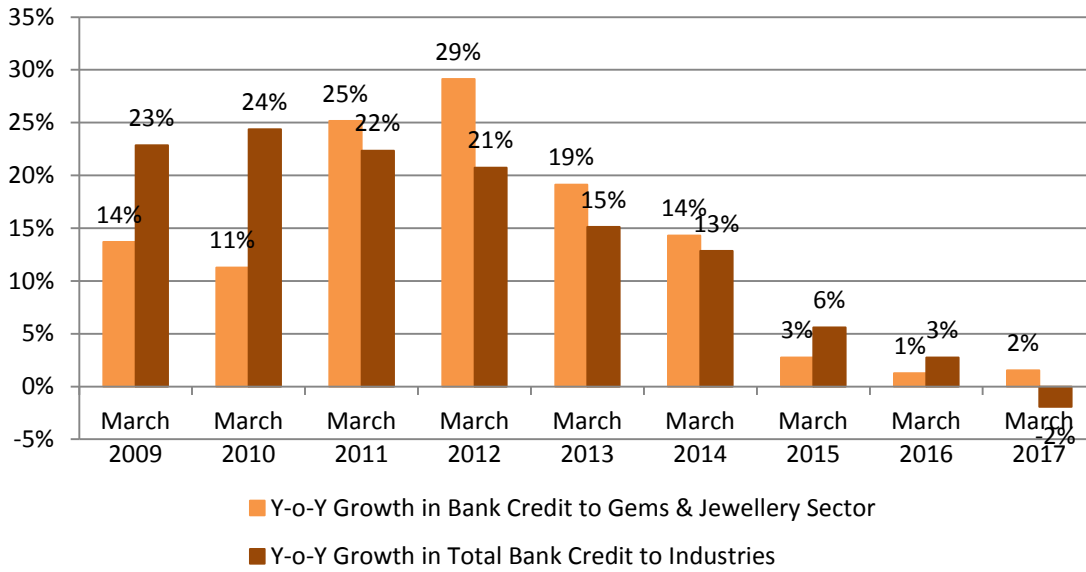
### Mining and Trading

- Major mining companies such as Rio Tinto, De Beers and Alrosa have decided to participate in the Indian Diamond Trading Centre (IDTC) which has been set up to eliminate the middlemen in diamond trade and allow Indian manufacturers to deal directly with miners.
- India Bullion and Jewellers Association (IBJA) has signed an pact with the Bombay Stock Exchange (BSE) for setting up India's first bullion exchange through a Special Purpose Vehicle (SPV), wherein IBJA and its constituents will hold 70% and BSE will hold 30% stake.
- London-headquartered Gemfields, a multi-national firm specialising in colour gemstones mining and marketing, is planning to acquire colour gemstone mines in Odisha and Jharkhand, and participate in the exploration of the Kashmir sapphire mines in Jammu & Kashmir.

### Credit exposure to the sector:

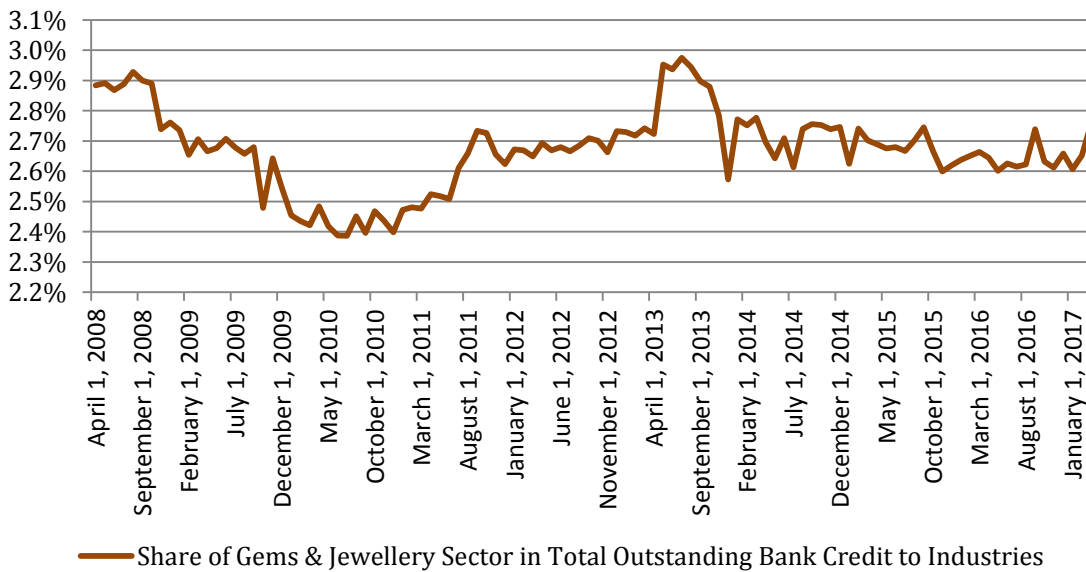
Share of gems & jewellery sector in the total credit exposure of banks to industries has been in the range of 2.5% to 3%. The share of exposure to the sector had seen a drop during 2009 & 2010 period, post the global financial crisis in 2008. However post 2011, the credit exposure of banks to gems & jewellery sector picked up; with y-o-y growth in bank credit exposure the sector continuing to be higher than the y-o-y growth in overall bank credit to industries till FY14. In FY15 & FY16, the share of exposure to gems & jewellery sector exhibited a dip. This was on the back of overall glut in the polished diamond market globally. At the end of FY17, there was again an improvement in bank's exposure to gems & jewellery sector, which was at Rs.738 billion as against Rs.727 billion at the end of FY16.

**Chart 13: Trend in Growth in Credit Exposure of Banks to Gems & Jewellery Sector vis-à-vis Other Industries:**



Source: RBI

**Chart 14: Trend in Share of Gems & Jewellery Sector in Total Outstanding Bank Credit to Industries:**



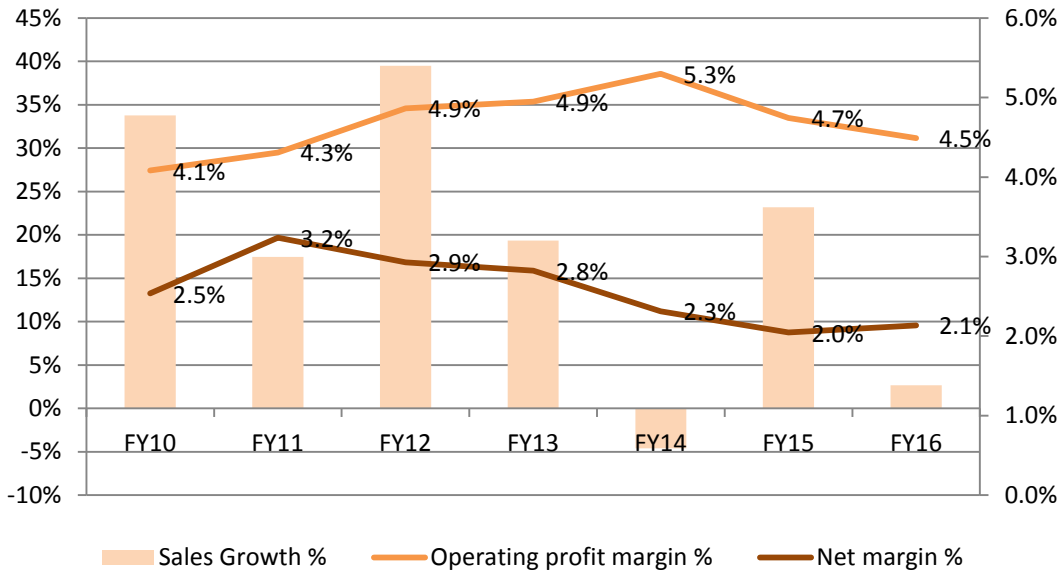
Source: RBI

**Financial Performance:**

A representative set of 64 companies in the diamonds and jewellery sector have been considered for analysing the financial performance of the sector. As can be seen from the chart below, the revenue exhibited a drop in FY14. Consequently, the

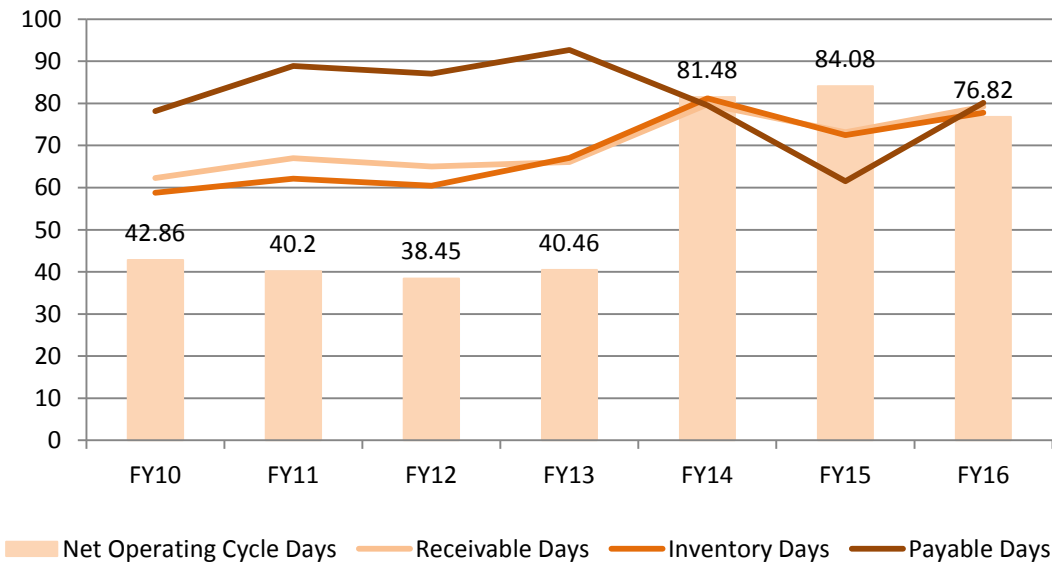
working capital cycle and leverage parameters worsened. Further in FY15, profit margins exhibited a drop as the industry saw the players offloading their inventory at lower price levels. The drop in margins continued in FY16.

**Chart 15: Trend in Sales Growth & Profit Margins**



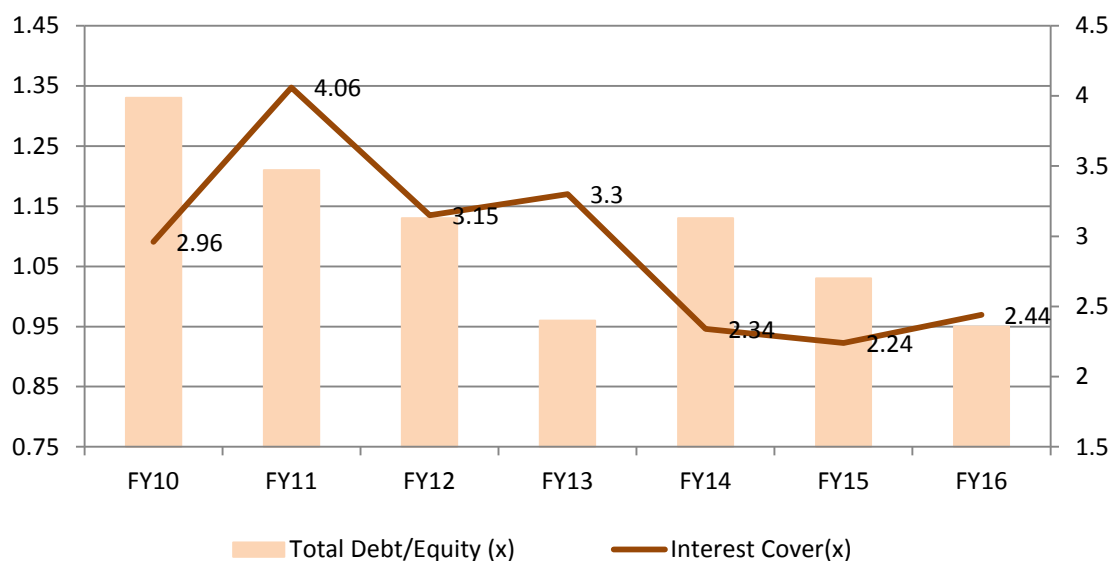
Source: ACE Equity

**Chart 16: Trend in Working Capital Cycle**



Source: ACE Equity

**Chart 17: Trend in Leverage and Interest Coverage**



Source: ACE Equity

### **Outlook for the Industry:**

- Retail jewellery segment in the country is expected to see double digit growth rates in revenue in FY18 on back of regulatory headwinds fading out and continued favorable demographics. Margins of retail players are expected to see improvement over medium term with availability of gold metal loans and increase in share of higher margins diamond and precious stone studded jewellery.
- Branding would continue to gain significance. Share of national and regional organized jewellery retailers is expected to grow.
- Retailers are also expected to see some benefit from the revival of the gold savings scheme and increase in limit of the amount collectible under the scheme to 35% of net worth.
- Overall domestic gems & jewellery demand would see a growth of 6% - 7% in volume terms over a medium term.
- Globally gems & jewellery would see mix consumption pattern with more people moving up in some parts of the world to higher carat and higher value pieces on one hand; and price war at the lower end of the market.
- Supply of rough diamonds is expected to continue to remain tight going ahead which would push up the rough diamond prices. A balance is expected to be maintained with the demand.
- Pressure on profit margins for cut & polished diamond exporters (midstream players) would continue over near to medium term. The global gems & jewellery demand continue to remain lackluster with no major pick-up in demand from US or China and continued uncertainties in UK and Europe in early 2017. Given the lack of bargaining power

with the midstream players and extremely thin profit margins, smaller midstream players may find it unviable to operate as the current scenario extends.

- However, India overall is expected to continue to gain share in the rough diamond trade globally. De Beers recently has set up their auction sale centers in Mumbai, India while shutting down the Dubai center. The global rough diamond auction business has started shifting to Mumbai since the establishment of the special notified zone in the Bharat Diamond Bourse in 2015.

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