

Titan Industries

STOCK INFO.	BLOOMBERG
BSE SENSEX: 10,227	TTAN IN
	REUTERS CODE
S&P CNX: 2,994	TITN.BO

18 July 2006

Buy

Rs560

Previous Recommendation: Buy

Equity Shares (m)	42.3
52-Week Range	895/389
1,6,12 Rel. Perf. (%)	-8/-32/-30
M.Cap. (Rs b)	23.7
M.Cap. (US\$ b)	0.5

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
03/06A	14,402	986	22.9	51.1	24.4	13.3	38.4	23.8	1.8	15.5
03/07E	17,445	1,288	29.0	26.6	19.3	9.2	31.7	26.2	1.5	12.0
03/08E	21,359	1,761	39.7	36.7	14.1	5.8	31.6	31.8	1.1	9.1

- 1QFY07 results were below expectations — PAT came in at Rs70m compared with our estimates of Rs118m.
- Revenue increased 50.5% YoY, with gross profit rising by 37.6%. EBITDA increased merely 7.9% YoY, as advertising expenses increased 55.2% YoY. PBT from operations increased by 44.5 % YoY, as interest burden declined by 15.7% YoY. Overall PBT increased by 58.2 % YoY, as other income increased by 187%. PAT declined 7.4% owing to the company making provision for taxes of Rs11.7m v/s tax credit of Rs23.8m.
- 1QFY07 sales of the watch division rose 17.9% YoY and PBIT increased 92.1% YoY, as the division expanded margins by 330bp. 1QFY07 jewelry sales increased 73.3% while PBIT declined 42%, as margins declined by 370bp on a YoY basis.
- Management expects watches to continue their robust performance due to rising sales of the higher-margin Titan and Raga brand watches. Jewelry should report improved QoQ margins going forward, as the increase in advertising expense and overheads even out during the course of the year. Precision engineering business is in the ramp-up stage with expected breakeven by end-FY07.
- The stock is currently trading at 19.3x FY07E and 14.1x FY08E earnings. Maintain **Buy**.

Y/E MARCH	FY06				FY07				(Rs Million)	
	1Q	2Q	3Q	4Q	1Q	2QE	3QE	4QE	FY06	FY07E
Net Sales	2,862	3,488	3,649	4,231	4,410	4,250	4,350	4,435	14,402	17,445
YoY Change (%)	42.9	27.8	24.0	33.1	54.1	21.8	19.2	4.8	31.3	21.1
Total Exp	2,709	2,938	3,350	3,693	4,245	3,550	4,000	3,693	12,862	15,412
EBITDA	153	551	299	537	165	700	350	818	1,540	2,033
Margins (%)	5.3	15.8	8.2	12.7	3.7	16.5	8.0	18.4	10.7	11.7
Depreciation	-49	-48	-49	-52	-49	-55	-60	-70	-197	-234
Interest	-58	-60	-73	-58	-49	-55	-67	-56	-248	-227
Other Income	5	6	4	10	14	9	7	8	24	38
PBT	51	449	181	438	81	599	230	700	1,119	1,610
Tax	24	-91	-48	-19	-12	-130	-60	-120	-133	-322
Rate (%)	-46.3	20.2	26.5	4.3	14.4	21.7	26.1	17.2	11.9	20.0
PAT	75	358	133	419	70	469	170	579	986	1,288
YoY Change (%)	230.1	179.3	15.7	7.7	-7.4	30.9	27.9	38.3	64.5	30.6
Extraordinary Items	-25	-152	-25	-48	-29	0	0	0	-250	0
Reported PAT	50	206	108	371	41	469	170	579	736	1,288

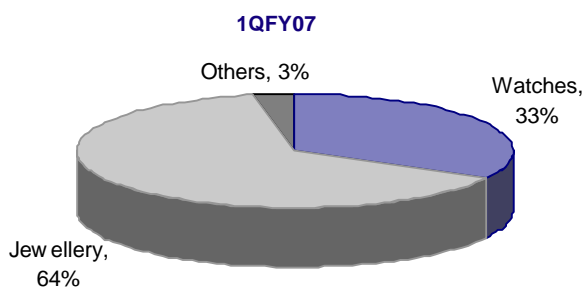
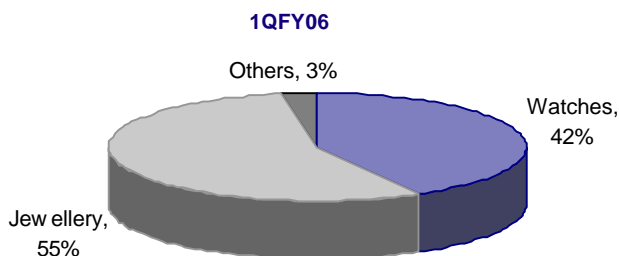
E: MOST Estimates

Huge adspend mars robust performance

Titan Industries maintained robust performance during the quarter, as sales increased by 50.5%. The staff costs include Rs30m provision for the expected increase in wages due to the pending wage revision settlement. EBITDA margin declined by 150bp as sales mix shifted in favor of lower margin jewelry. PAT declined as the company had a substantial deferred tax component in 1QFY06 due to which there was tax credit of Rs23.8m against tax provision of Rs 11.7m in 1QFY07.

The company increased advertising expenses by 55% during 1QFY07 on a YoY basis. This dragged profit growth. Titan has chosen movie actor Rani Mukherjee as brand ambassador for its Raga range of premium watches, during the quarter. We note advertising costs fluctuate widely during the year; we expect this cost increase to even out during the course of the year.

SALES MIX: SHIFTING TOWARDS JEWELLERY

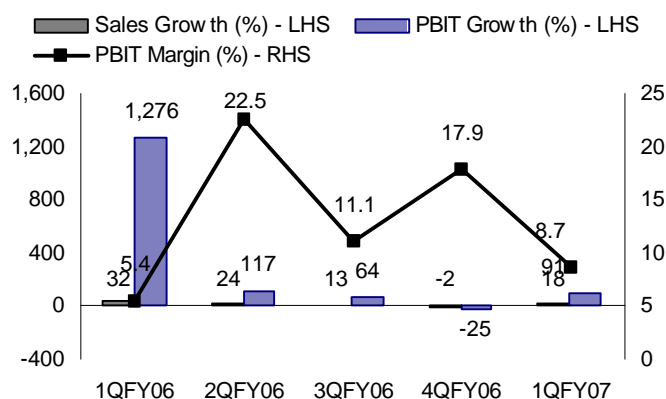


Source: Company/ Motilal Oswal Securities

Watch division – Premium brands power growth

The watch division recorded 17.9% increase in sales and 92.1% increase in PBIT on a YoY basis. PBIT margin expanded by 320bp. Sonata sales volumes reported slack growth while premium brands such as Titan, Raga, and Fastrack powered growth. The faster growth in premium watches augurs well for long term profitability of this SBU due to the huge margin differential separating premium and mass-market brands.

WATCHES: ROBUST YOY GROWTH (%)



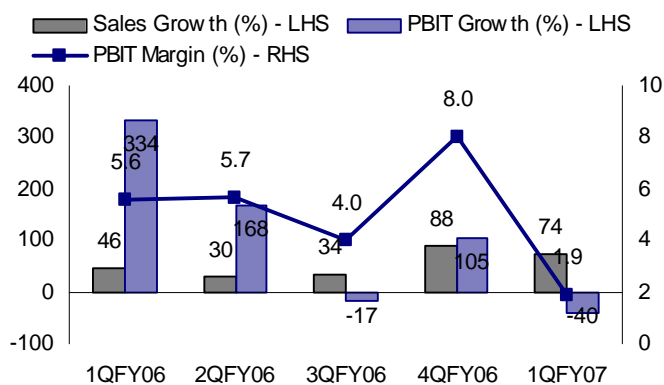
Source: Company/ Motilal Oswal Securities

Titan had launched the Xylus brand of premium Swiss made watches a few months ago. The initial response has been encouraging but the company is looking forward to the festive season to judge the actual impact. The product is priced at 25%-30% discount to branded Swiss watches. We expect the watch SBU to maintain double-digit volume growth in the coming quarters. We expect rising sales of premium watches to expand the profit margins of this SBU ahead.

Jewelry division – poor sales mix, adspend and higher prices drag margins

The jewelry division posted robust sales growth of 73.3% supported by 35% volume growth. However, PBIT declined 40% during 1QFY07 on a YoY basis and PBIT margin took a sharp beating with margins sliding 370bp-190bp.

JEWELRY: HIGH SALES GROWTH AND LOWER MARGINS (YOY)



Source: Company/ Motilal Oswal Securities

As the jewelry division operates on fixed making charges per gram of jewelry, a 40% increase in gold prices YoY, has been one of the key reasons for this decline in margins. Our estimates indicate that jewelry EBITDA margins should have declined by 200bp due to 40% increase in gold price, but the decline in jewelry margins is much higher. We estimate that the company was not able to control the overheads and advertising expense, which depressed margins by an estimated 100bp and 70bp respectively. In addition gold jewellery sales had high proportion of low margin gold coins which impacted 1QFY07 profitability.

Management expects this division to post robust volume growth during the rest of the year. Advertising cost and overheads are likely to decline from current high levels, leading to higher profitability.

Precision engineering: year-end breakeven likely

PE business which has been facing certification problems over the past couple of quarters is quickly reaching the ramp-up stage. This business achieved sales of Rs80m during the current quarter. The business offers huge growth potential and is the single largest SBU in terms of new investments. Management expects the SBU to report sales of Rs550m-Rs600m during FY07 with breakeven by the end of the year.

Accessories – entering the premium segment

Titan entered the premium market for accessories with the launch of Titan Shades Sunglasses. The product which is priced in the range of more than Rs2,500 is the only Indian brand in the premium segment. The market for sunglasses is growing by more than 20% per annum due to favorable demographics and rising aspiration levels of consumers. Titan is already well entrenched in the sunglasses market with Fastrack brand in the mid-price segment. Titan Sunglasses is being marketed via The World of Titan, exclusive outlets of the company. Success of Titan Sunglasses can open up yet another premium end high margin segment for the company.

Retail network and new products hold potential

Titan Industries is currently on a major drive to increase its retail presence. The company closed FY06 with 182 World of Titan outlets, which have grown to 188 currently. Plans include 80 owned World of Titan Stores and 4 Tanishq boutiques. Expansion of retail network in high streets and malls will push sales of premium products of the company. Titan Industries plans to enter the prescription eyewear business in India. The business holds huge growth potential due to the absence of any brand and retail chain in the prescription eyewear business.

Valuation and view

Despite lower-than-expected results during 1QFY07 we expect the company to meet our expectations for adjusted EPS of Rs29 in FY07. 1QFY07 is usually a weak quarter and accounts for just 7%-10% of profits. While the jewelry margins have been lower, sales momentum build-up in 1QFY07 (both watches and jewellery) and improved sales mix in watches holds potential. The stock is currently trading at 19.3x for FY07 and 14.1x for FY08 earnings. **Maintain Buy.**

Titan Industries: an investment profile

Company description

Titan Inds is a Joint venture between Tata Group and TIDCO (Tamilnadu Industrial Development Corporation). The company is the largest specialty retailer and market leader in branded watches and Jewellery products in India. The company has also been able to tap the fast growing demand for accessories and precision engineering components. Major brands of the company include Titan, Tanishq, Sonata, & Fastrack.

Key investment arguments

- ☞ Titan Inds has 50% market share in branded jewellery market, strong growth and low penetration of branded jewellery will result in rising profit margins.
- ☞ Watches are expected to report steady growth due to strong brands and huge success in mass market brand Sonata, only company in the retail sector generating free cash flows.

Key investment risks

- ☞ Slower than expected ramp up in the precision engineering business
- ☞ Down trading by consumers resulting in shift in demand from branded jewellery and mid to premium end watches.

Recent developments

- ☞ Launch of Xylus brand of premium watches.
- ☞ Successful conclusion of Rs1,250m rights issue.

Valuation and view

- ☞ We have EPS estimates of Rs29x for FY07 and Rs39.7x for FY08.
- ☞ Titan is the cheapest retail stock, despite strong brands, free cash flow and excellent long term growth potential.

Sector view

- ☞ We have a positive view on the sector. We expect the sector to clock revenue growth of 30%-35% CAGR over the next five years.
- ☞ Players with a strong hypermarket format and presence in a larger number of categories are likely to be winners; specialty retailers with strong brands will have steady growth ahead.
- ☞ Ability to increase private labels, squeeze costs and extract higher margins from branded players will be a key factor in maintaining margins in the long term.

COMPARATIVE VALUATIONS

		TITAN	SHOPPERS	PANTALOON
P/E (x)	FY07E	19.3	50.1	27.6
	FY08E	14.1	39.8	17.4
EV/EBITDA (x)	FY07E	12.0	25.0	15.4
	FY08E	9.1	18.4	10.5
EV/Sales (x)	FY07E	1.5	2.1	1.1
	FY08E	1.1	1.5	0.8
P/BV (x)	FY07E	5.8	5.7	5.6
	FY08E	4.2	5.1	4.4

SHAREHOLDING PATTERN (%)

	JUN.06	MAR.06	JUN.05
Promoters	52.9	52.9	52.7
Domestic Institutions	1.0	1.0	1.7
FIs/FDIs	11.9	9.5	11.6
Others	34.2	36.6	34.0

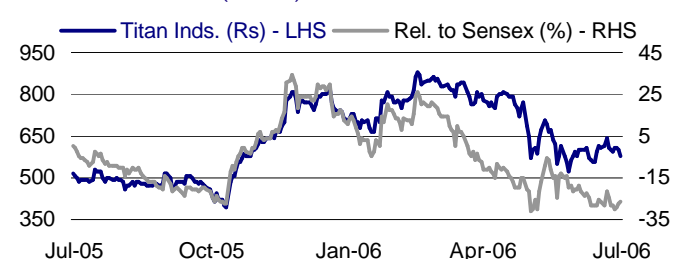
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	29.0	27.7	4.7
FY08	39.7	37.1	7.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
560	720	28.7	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT						(RS MILLION)					
Y/E MARCH	2004	2005	2006E	2007E	2008E						
Net Sales	8,949	10,799	14,162	17,445	21,359						
Change (%)	216	20.7	311	23.2	22.4						
Total Expenditure	-7,850	-9,460	-12,472	-15,316	-18,691						
EBITDA	1,098	1,339	1,690	2,129	2,668						
Change (%)	29.1	21.9	26.2	26.0	25.3						
Margin (%)	12.3	12.4	11.9	12.2	12.5						
Depreciation	-215	-196	-208	-234	-263						
Int. and Fin. Charges	-376	-309	-252	-227	-154						
Other Income - Recurring	21	27	32	38	41						
Deferred Revenue Expendit	-136	-142	-96	-96	-20						
Profit before Taxes	393	719	1,166	1,610	2,272						
Change (%)	257.2	83.2	62.1	38.1	41.1						
Margin (%)	4.4	6.7	8.2	9.2	10.6						
Tax	-90	-108	-175	-322	-511						
Deferred Tax	64	58	0	0	0						
Tax Rate (%)	-6.4	-7.0	-15.0	-20.0	-22.5						
Profit after Taxes	368	669	991	1,288	1,761						
Change (%)	303.3	82.1	48.1	30.0	36.7						
Margin (%)	4.1	6.2	7.0	7.4	8.2						
Extraordinary Items	-256	-420	-202	0	0						
Reported PAT	112	249	789	1,288	1,761						

BALANCE SHEET						(RS MILLION)					
Y/E MARCH	2004	2005	2006E	2007E	2008E						
Share Capital	423	423	423	444	444						
Preference Share Capital	400	400	400	2	0						
Reserves	828	950	1,755	3,620	5,130						
Net Worth	1,651	1,772	2,578	4,066	5,574						
Loans	4,070	3,180	3,062	2,569	1,613						
Deferred Tax	351	293	319	368	444						
Capital Employed	6,073	5,246	5,959	7,002	7,632						
Gross Block	3,934	4,001	4,501	5,258	5,827						
Less: Accum. Deprn.	-2,201	-2,349	-2,558	-2,792	-3,055						
Net Fixed Assets	1,733	1,651	1,943	2,466	2,771						
Capital WIP	41	98	30	30	30						
Investments	276	270	330	330	330						
Curr. Assets, L&A	5,340	5,649	6,541	7,861	9,367						
Inventory	1,641	2,716	2,832	3,489	4,068						
Account Receivables	1,482	771	1,138	1,390	1,813						
Cash and Bank Balance	271	440	585	725	891						
Others	1,946	1,721	1,986	2,257	2,595						
Curr. Liab. and Prov.	1,650	2,666	3,033	3,737	4,866						
Account Payables	1,475	2,446	2,724	3,326	4,351						
Other Liabilities	60	43	45	47	50						
Provisions	115	177	265	364	466						
Net Current Assets	3,690	2,983	3,508	4,124	4,501						
Miscellaneous Expenditure	333	244	148	52	0						
Application of Funds	6,073	5,246	5,959	7,002	7,632						

E: MOST Estimates

RATIOS					
Y/E MARCH	2004	2005	2006E	2007E	2008E
Basic (Rs)					
EPS	7.9	15.2	22.9	29.0	39.7
Cash EPS	13.0	19.8	27.8	36.0	47.9
BV/Share	39.1	41.9	61.0	96.2	131.8
DPS	5.2	6.9	4.3	4.5	5.6
Payout %	66.1	45.3	18.7	15.5	14.2
Valuation (x)					
P/E		36.9	24.4	19.3	14.1
Cash P/E		28.3	20.1	15.5	11.7
EV/Sales		2.4	1.8	1.5	1.1
EV/EBITDA		19.7	15.5	12.0	9.1
P/BV		13.3	9.2	5.8	4.2
Dividend Yield (%)		12	0.8	0.8	10
Return Ratios (%)					
RoE	22.3	37.8	38.4	31.7	31.6
RoCE	12.7	19.6	23.8	26.2	31.8
Working Capital Ratios					
Debtor (Days)	60	26	29	29	31
Asset Turnover (x)	15	2.1	2.4	2.5	2.8
Leverage Ratio					
Debt/Equity (x)	2.5	18	12	0.6	0.3

CASH FLOW STATEMENT						(RS MILLION)					
Y/E MARCH	2004	2005	2006E	2007E	2008E						
OP/(loss) before Tax	884	1,143	1,482	1,895	2,405						
Int./Div. Received	21	27	32	38	41						
Depreciation and Amort.	215	196	208	234	263						
Interest Paid	-376	-309	-252	-227	-154						
Direct Taxes Paid	-90	-108	-175	-322	-511						
(Incr)/Decr in WC	302	876	-381	-475	-211						
CF from Operations	956	1,825	914	1,143	1,833						
Extraordinary Items	-256	-420	-202	0	0						
(Incr)/Decr in FA	-61	-124	-432	-757	-568						
(Pur)/Sale of Investments	95	6	-60	0	0						
CF from Invest.	-222	-538	-694	-757	-568						
Issue of Shares	0	0	793	21	0						
Incr/(Decr) in Debt	-601	-890	-118	-493	-955						
Dividend Paid	-221	-291	-181	-191	-238						
Others	119	62	-570	417	95						
CF from Fin. Activity	-703	-1,119	-76	-246	-1,099						
Incr/Decr of Cash	32	168	144	140	166						
Add: Opening Balance	240	271	440	585	725						
Closing Balance	271	440	584	725	891						



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Titan Industries

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|---|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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