MOTILAL OSWAL

Update

SECTOR: RETAILING

Titan Industries

STOCK INFO.	BLOOMBERG
BSE Sensex: 10,482	TTAN IN
	REUTERS CODE
S&P CNX: 3,081	TITN.BO

Equity Shares (m)	42.3
52-Week Range	895/291
1,6,12 Rel. Perf. (%)	-14/-33/34
M.Cap. (Rs b)	24.1
M.Cap. (US$ b)	0.5

22 May 2006

Buy

Previous Recommendation: Neutral

Rs570

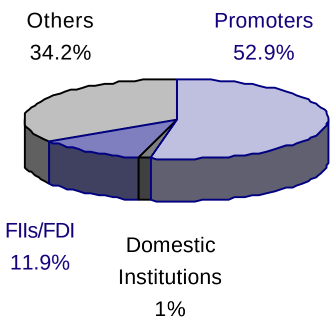
YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
03/06A	14,162	991	22.9	51.1	24.9	13.6	38.4	23.8	1.9	15.7
03/07E	17,445	1,288	29.0	26.6	19.7	9.4	31.7	26.2	1.5	12.2
03/08E	21,359	1,761	39.7	36.7	14.4	5.9	31.6	31.8	1.2	9.3

Strong retailing initiative to help drive growth: Titan has one of the largest exclusive networks of specialty stores for retailing its brands. Currently, it has 179 World of Titan stores (of which six are company-managed), 130 Time Zone stores, and 81 Tanishq Boutiques (of which six are company-managed). Titan intends to add 82 company-managed World of Titan stores and 4 company-managed Tanishq Boutiques during the next two years. It plans to have a total of 100 Tanishq Boutiques and increase its department store presence from 29 to 110 over the next 1-2 years. We believe that the company's thrust on retailing would help drive growth.

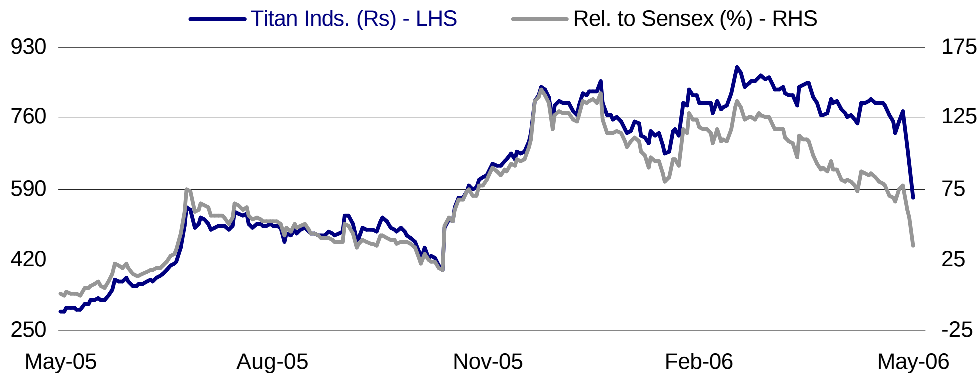
Changing sales mix to drive up margins: Titan Industries is consciously changing its sales mix in favor of high margin products. In watches, it has launched the premium Xylys range priced at Rs10,000-30,000/unit. Besides, the company's increasing retail presence in malls is likely to result in higher sales of its Titan brand vis-à-vis its low-end Sonata brand. In jewellery, it is focusing on increasing the sales of diamond-studded products, which yield higher margins than plain gold products. Besides, the company is making efforts to reduce costs. This too should aid margin expansion.

Cheapest retailing stock; Buy: Despite its strong free cash flows, Titan is the cheapest retailing stock in India. While other retailing companies command high multiples of 25-30x FY08E, Titan quotes at 14x FY08E. Usually, specialty retailers quote at a discount to hypermarkets and departmental stores. Even after considering 25% valuation discount to grocery retailers, the stock should command a P/E multiple of 18-20x. We expect the company to report 37% CAGR in PAT during FY06-08, which leaves the stock quoting at a PEG of less than 0.4. We upgrade the stock from Neutral to **Buy** with a target price of Rs720.

SHAREHOLDING PATTERN (%)



STOCK PERFORMANCE (1 YEAR)



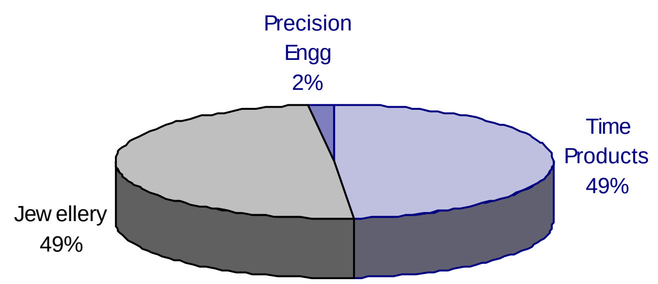
Amnish Aggarwal (AmnishAggarwal@MotilalOswal.com)Tel:+912239825404/Sidharth Shah (Sidharths@MotilalOswal.com);Tel:+912239825414

Play on rising disposable income

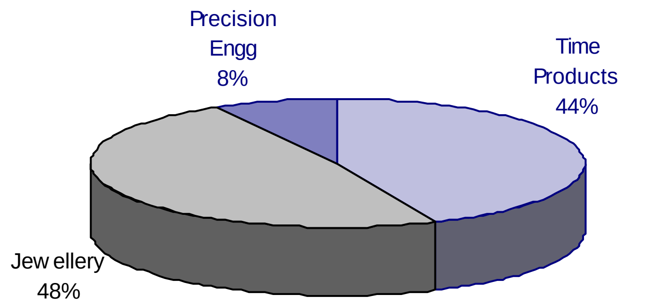
Titan Industries is a strong play on the huge potential offered by rising disposable incomes of the Indian population. Titan caters to all segments of the domestic watch market, with brands like *Titan*, *Xylys*, *Sonata* and *Fastrack*. Its *Tanishq* is the largest brand in the jewellery market worth Rs14b (total jewellery market size of Rs650b), with the target market being the female population in India. The company has also launched fashion accessories such as sunglasses to target teenagers and the young adult population, which form the heart of India's consuming class.

SALES MIX

FY05



FY08



Source: Company/Motilal Oswal Securities

Watches – key profit driver

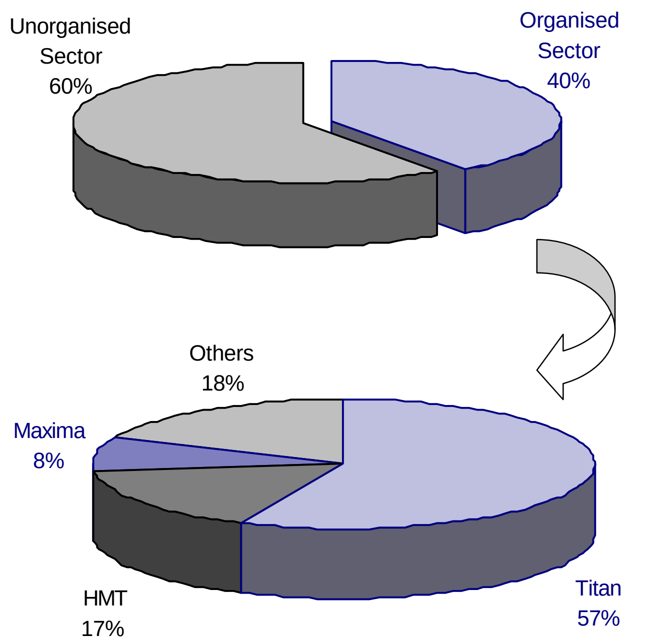
Titan holds 57% market share in the organized segment of the domestic watch industry worth 14m pieces, which has been growing at 7-8% per annum. Titan has been able to expand its product range so as to cater to all the segments of the watch market ranging from super premium to mass market.

OFFERING A WHOLE RANGE OF WATCHES

BRAND	SEGMENT	COMPETITORS	PRICING
Xylys, Nebula	Super Premium	Swatch, Omega, Rolex, Tag Hueur	10,000-50,000
Titan	Premium	Citizen	1,200-5,000
Tommy Hilfiger, Raga, Bandhan	Fashion	Espirit, Addidas, Gucci	1,900-5,000
Fastrack	Youth	Timex	500-2,250
Sonata	Mass Market	HMT, Maxima	295-1,050

Source: Company/Motilal Oswal Securities

TITAN: THE LEADER IN THE ORGANIZED SEGMENT



Source: Company/Motilal Oswal Securities

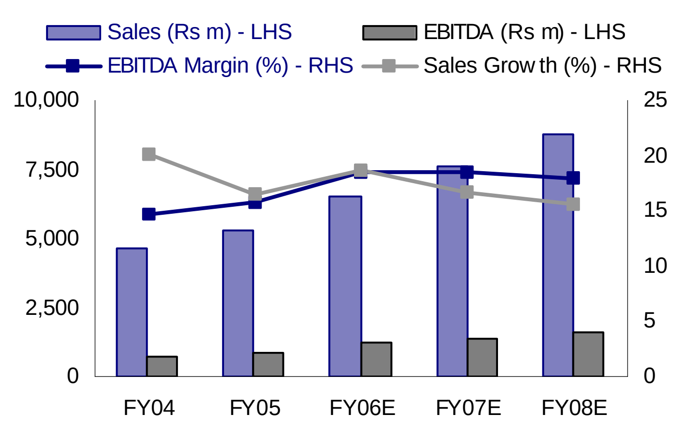
Sales mix holds the key to margins: Sales mix holds the key to Titan's profitability in the watch segment. Higher sales of premium *Titan* brand watches boost profitability significantly due to margin differential with the *Sonata* brand watches. This was reflected during 2QFY06 when favorable sales mix boosted the company's PBIT margin by 960bp on a YoY basis. Titan has launched *Sonata* watches at Rs295/unit to compete against the unorganized and grey market players. The unorganized segment constitutes 60% of India's total watch market. Simultaneously, the company has launched the *Xylys* range of premium watches priced at Rs10,000-30,000/unit based on Swiss technology. We have factored in rising sales of

Sonata watches in our estimates. Any favorable shift in sales mix will have a positive impact on the expected profit margins of the watch division.

Backward area benefits to boost margins: Titan Industries has set up watch assembly units in notified backward areas of Dehradun and Baddi. These units now account for 50% of the company's watch assembly capacity. The new units qualify for excise and income tax benefits. The strategy of setting up units in backward areas was a part of the game plan to save tax incidence so as to effectively compete with the unorganized sector in the lower end *Sonata* watches. The company has also planned assembly of *Titan* brand premium watches at these locations. It plans to shift part of the assembly of *Titan* watches from Hosur to backward areas. This will result in higher excise savings and boost the incremental profitability of the company.

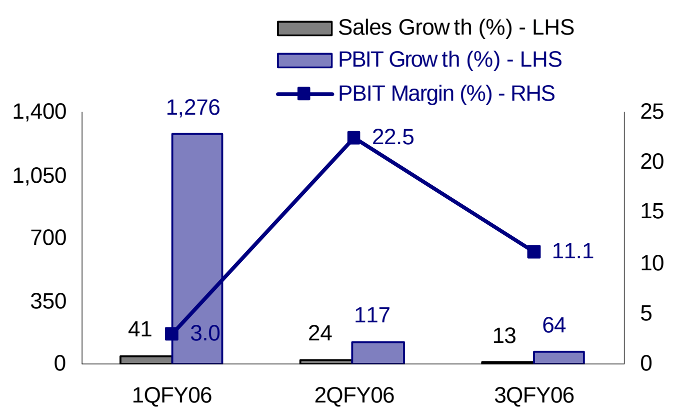
Cost cutting initiatives to continue: The company is increasing outsourcing of watch components and movements. It has nurtured a clutch of ancillary units around Bangalore for this purpose and is also importing some components from China and Hong Kong. The outsourcing is mainly done for the *Sonata* brand of watches. Components purchased as a percentage of sales have increased from 26% in FY01 to 33.8% in FY04. Increasing outsourcing of components has also kept the capital employed under check.

WATCH DIVISION PERFORMANCE



Source: Company/Motilal Oswal Securities

WATCH DIVISION PERFORMANCE - QUARTERLY



Source: Company/Motilal Oswal Securities

Tanishq – high growth path

Tanishq, Titan's branded jewellery brand, is the market leader in Rs14b branded jewellery market in India. India's jewellery market is the largest in the world and is growing at 5-7% per annum. Branded jewellery accounts for just 3% of the total jewellery market in India. A Mckinsey study suggests that the branded jewellery market in India is likely to grow at 40% per annum to Rs100b in the next five years, due to the following reasons:

- The guarantee of quality and purity associated with branded jewellery
- Modern designs targeted at working women, who prefer lighter products
- Rising consumer aspirations associated with changing lifestyles
- Shopping experience associated with branded jewellers
- Rising purchasing power and disposable incomes
- Entry of more retailers in the branded jewellery space will expand the market; Tanishq will be the biggest beneficiary due to head start over others

Tanishq continues to be a low margin business, with EBITDA margins of 5.8% in FY05. The company has plans to increase margins from Tanishq in the coming years:

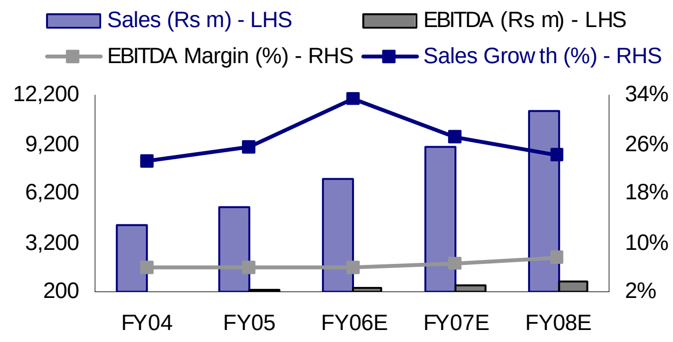
- Tanishq drives more than 2/3rd of its sales from plain gold jewellery and gold coins. The company outsources the entire requirement of plain gold jewellery. Limitation on increasing the making charges (Rs60-140 per gram) and competition from unorganized sector limits the margin expansion potential.

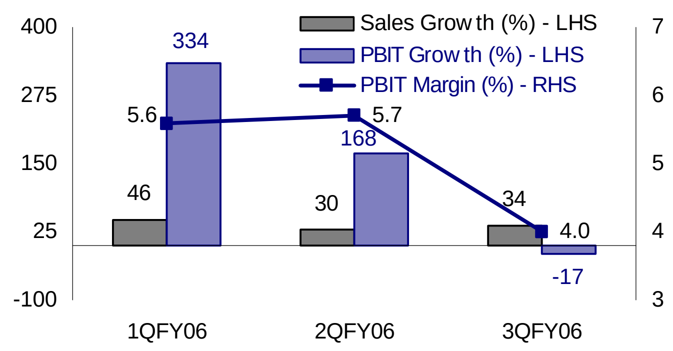
- Tanishq has been consciously pushing for higher sales of diamond-studded jewellery, which offers much higher margins. The company plans to increase the sales proportion of diamonds to 45% in the coming 3-4 years.
- The company, which has improved its stock turns from 2 to 3, plans to increase it to 4, which would boost profitability.
- Implementation of ERP is expected to boost margins.
- New jewellery manufacturing facility in backward area of Dehradun will provide excise and income tax benefits.

We expect EBITDA margins to expand by 200bp in the coming two years due to higher sales proportion of diamond-studded jewellery and lower overheads costs, despite increase in advertising expenses.

Titan Industries has started two pure gold jewellery outlets under the brand *Gold Plus* on pilot basis. The company envisages huge opportunity in the gold jewellery business. The feedback from the project has been encouraging.

JEWELLERY DIVISION PERFORMANCE





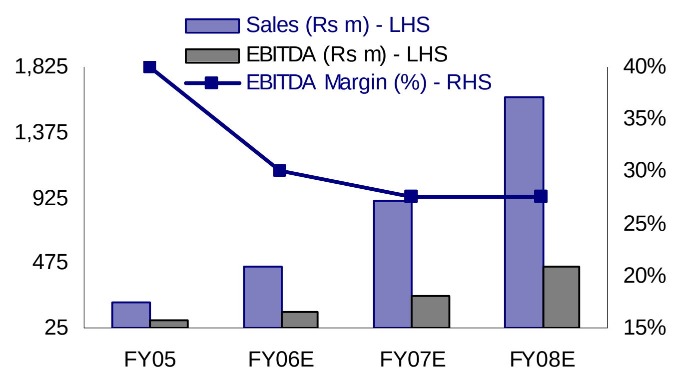
Source: Company/Motilal Oswal Securities

PE components – potential profit driver

Titan set up its Precision Engineering (PE) SBU to reduce the cost of manufacturing watches, by developing capabilities in high precision metal and plastic engineering. Over time, the SBU has developed capabilities to provide critical PE components for the aerospace industry and dashboard clocks. Global majors like Ford, Delphi, UTC, Moog, Tyco, Knorr and Bhremse are its key clients. We expect this SBU to be a profit driver in the long term due to the following reasons:

- Titan has a two-pronged strategy in place, which involves tying-up with technology suppliers to move up the value chain.
- The company has developed PE components for medical equipment, which is likely to be a high-growth, high-margin business.
- The company has already commissioned a new unit during the year, which would enable the business to scale up.
- Titan is upgrading technology for moving up the value chain from component supplier to a supplier of sub-assemblies
- It plans to enter PE components for Pharma, Telecom and Electronics industry.
- The company aims to achieve sales growth of 70% per annum in the coming 4-5 years. With capital constrains getting over; thanks to rights issue, we believe that the company would be able to scale up the business substantially.

PE COMPONENTS DIVISION PERFORMANCE



Source: Company/Motilal Oswal Securities

Retail – renewed thrust

Titan has one of the largest exclusive networks of specialty stores for retailing its brands. The company has 179 exclusive *World of Titan* stores and 130 *Time Zone* stores for retailing watches and accessories. Six of the flagship stores are company owned while the rest are on the franchise model. Branded jewellery is being marketed exclusively through 81 *Tanishq Boutiques* spread across 61 towns. The company has planned aggressive store rollout in the coming two years to maintain growth momentum in both the product lines. Plans include setting up 86 additional stores in the coming two years, of which 82 will be *World of Titan* stores and 4 *Tanishq Boutiques*. The company has planned capex of Rs536m in FY07 and FY08.

RETAIL EXPANSION PLANS

	WORLD OF TITAN		TANISHQ		ADDI-	EXIS-	TOTAL
	FY07	FY08	FY07	FY08	TION	TING	
Stores							
Addition	57	25	1	3	86	12	98
Capex	263	198	20	55	536	n.a	n.a

Source: Company/Motilal Oswal Securities

Titan has been following a mix of company managed/owned stores and franchise model for the retail venture. Only six *World of Titan* and six *Tanishq Boutiques* are company owned/managed outlets as of now. The rest of the outlets are franchisees or departmental store presence. The planned initiative is a bold move by the company to gain from the rising impact of organized retailing on sales of accessories. The number of company-managed outlets will increase from six to 88 for *World of Titan* and from six to 10 for *Tanishq*, a 700% jump in managed outlets in two years.

The expansion of retail network is separate from the current move and will proceed according to the earlier plans of increasing the number of *Tanishq Boutiques* to 100 in the coming 1-2 years and departmental store presence to 110 stores from current level 29.

Titan plans to add more than 2/3rd of *World of Titan* stores in shopping malls, which would substantially improve the company's visibility in the middle to upper middle class sections. Titan intends to focus on shopping malls for *World of Titan* outlets and on independent high street boutiques for *Tanishq*. Increased presence of *Titan Stores* in shopping malls could be a big margin driver for the company, as we expect the stores in malls to sell more of the *Titan* brand watches, which have substantially higher margins than mass market brand *Sonata* watches. The impact of such a margin expansion would be visible from FY08 after the stabilization of stores.

Rights issue to bolster balance sheet, enable capacity expansion

Titan Industries has come out with a rights issue of partially convertible debentures (PCDs), which will dilute equity by 5%, and will provide Rs1.3b, which will be utilized to retire preference capital of Rs400m and to partly fund the Rs1.1b expansion plan of watches, jewellery, PE and retail venture.

CAPEX PLAN (RS M)

	FY07	FY08
Retail	283.0	253.0
Watches	139.0	46.0
Jewellery	67.5.0	40.0
PE	200.0	150.0

Source: Company/Motilal Oswal Securities

Planned expansion will increase the watch assembly capacity at Baddi and Dehradun by 3m pieces. The company will also set up a 14,000 sq ft facility for making jewellery at Dehradun, which will be exempt from excise and income tax. In addition, the facility would include place for vendors, where they can manufacture gold jewellery for the company. PE capacity will be increased by spending Rs350m, which involves technology upgradation for moving up the value chain towards sub-assemblies from the components. Rights issue and strong free cash flows will enable the company to emerge financially stronger over the next couple of years. We expect the debt-equity ratio to decline from 2.61x in FY05 to 0.57x by FY07 and to 0.22x by FY08 (preference shares considered part of debt for calculation of Debt/Equity).

No major write-offs likely after FY06

Titan has made provisions of Rs202m in respect of slow moving watch stocks with the Middle East subsidiary. As nearly 80% of the value of stocks has been written off, we do not expect any write-offs after FY06. In addition, FY07 will mark the end of deferred revenue expenditure relating to VRS offered in FY02. Consequently, reported profit will get a boost in the coming years.

Valuation and view

Titan Industries is the largest specialty retailer in India with retail sales exceeding Rs7b. *Tanishq* is the market leader in the high growth branded jewellery market. The company has strong financials due to high growth and control over working capital. Titan has grown its sales by more than 50% in the past two years while the capital employed has declined by 25%. Free cash flow generation has been more than Rs2.7b in the last two years, resulting in debt declining by more than Rs1.5b. Titan is perhaps the only company in the retailing universe, with strong free cash flow generation.

Retailing companies are currently trading at high multiples of 25-30x FY08E while Titan quotes at 14x FY08E. Usually, specialty retailers quote at a discount to hypermarkets and departmental stores, but the valuation gap leaves a lot to be desired, in our opinion. Even after considering 25% valuation discount to grocery retailers, the stock should command a P/E multiple of 18-22x, in comparison to the current P/E multiple of 14x. We expect the company to report 37% CAGR in PAT during FY06-08, which leaves the stock quoting at a PEG of less than 0.4. We upgrade the stock from Neutral to **Buy**.

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 (%)	*21.6*	*20.7*	*31.1*	*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 Exp.	-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. Depn.	-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**
Miscelleneous 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		37.6	24.9	19.7	14.4
Cash P/E		28.8	20.5	15.8	11.9
EV/Sales		2.5	1.9	1.5	1.2
EV/EBITDA		20.0	15.7	12.2	9.3
P/BV		13.6	9.4	5.9	4.3
Dividend Yield (%)		1.2	0.7	0.8	1.0
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)	1.5	2.1	2.4	2.5	2.8
Leverage Ratio					
Debt/Equity (x)	2.5	1.8	1.2	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	421	102
CF from Fin. Activity	**-703**	**-1,119**	**-76**	**-242**	**-1,092**
Incr/Decr of Cash	**32**	**168**	**144**	**144**	**173**
Add: Opening Balance	240	271	440	585	725
Closing Balance	**271**	**440**	**584**	**729**	**898**

For more copies or other information, contact
Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari
Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motilaloswal.com

Disclosure of Interest Statement	Titan Industries
1. Analyst ownership of the stock	No
2. Group/Directors ownership of the stock	No
3. Broking relationship with company covered	No

MOSt is not engaged in providing investment-banking services.