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India Research

Sector: Retailing

The Account Shredder: Titan Industries Limited (TTAN.IN / TITN.BO)

Free Cash flows, Return Ratios, Revenue trends and more…

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Inventory rises due to expansion across business segments…

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Commanding superior returns despite rising working capital requirement & Capex

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Titan's Business in Pictures… (FY07)

(All figures are in Rs. Mn except where stated otherwise. All percentages are percent of revenues, unless otherwise stated)

Markets-
India, U.K., Middle East, South East Asia, Australia, Singapore etc.

Finished Products
Watches, clocks, Jewellery, Sunglasses, PE components, Prescription Eyewear

Installed capacity of 12 mn watch pieces & 0.29 mn jewellery pieces. Studded jewellery is made at Hosur factory, while plain gold jewellery outsourced. PE components outsourced from domestic market, Singapore & USA.

Operations/ Value added
Net Sales: Rs.20902 mn

Raw Material – Rs. 13744 mn (65.8%)

Manufacturing Exp – Rs. 184 mn (0.9%)

S ,G & A Exp– Rs. 3305 mn (15.8%)

Personnel exp – Rs. 1671 mn (8.0%)

EBIDTA – Rs. 1997 mn (9.6%)

Below Operating Line

Interest – Rs. 204 mn (1.0%)

Depreciation & Amortisation – Rs. 256 mn (1.2%)

Other Non-Operating Income – Rs. 32.2 mn (0.2%)

Extraordinary Expense (Net) – Rs. 253 mn (1.2%)

Profit Before Tax - Rs. 1317 mn (6.3%)

Taxes
Rs. 375 mn including deferred tax (1.8%)

Profit After Tax
Rs. 941 mn (4.5%)

Segmental Contribution
(Q1 FY07)
Time Products Segment- 26%
Jewellery Segment- ***71%***
Others - 3%
(Includes PE Components)

Manufacturing facilities
At Hosur, Baddi, Roorkee (Himachal Pradesh, Dehradun, Uttranchal)

Pricing
Time Products- Has products in both <Rs. 1000 and >Rs. 1000 segment

Jewellery- Margins are higher for diamond studded jewellery as compared to plain gold jewellery.

Competition
Time Products–
Organised Market HMT, Timex, Allwyn, Maxima, Citizen, Espirit, Tissot, Rolex, Rado, Longines, Swatch, Omega

Unorganised Market
Mainly imports from China

Jewellery Segment-
Organised Players- Adora, Kiah, D'damas Tribhovandas Bhimji Zaveri, Kirtilals, Gili, P.C. Sen, P.P., Mehrasons etc.
Unorganised Market
Estimated 0.3-0.5 mn local jewellers and craftsmen

Assets

Fixed Assets – Rs. 2671 mn (22.6%)
Investments – Rs. 270 mn (2.3%)
Inventories – Rs 6775 mn (57.2%)
Debtors – Rs. 921 mn (7.8%)
Cash – Rs. 507 mn (4.3%)
Loans & Advances – Rs. 655 mn (5.5%)
Misc. Assets – Rs. 42 mn (0.4%)

Inventories:
Finished Stock – 61%
Raw Material – 23%
WIP – 15%
Loose Tools - 1%

Balance Sheet
Rs. 11841 mn
(100%)

Liabilities

Debt – Rs. 2470 mn (20.9%)
Equity capital – Rs. 444 mn (3.7%)
Reserves – Rs. 1495 mn (12.6%)
Share Premium – Rs. 1336 mn (11.3%)
Def. Tax Liability & Others – Rs. 174 mn (1.5%)
S.Creditors – Rs. 5326 mn (45.0%)
Provisions & Others – Rs. 596 mn (5.0%)

Debt:
Secured: Rs.1727 mn
Unsecured: Rs.743 mn

Highlights

Titan Industries Ltd. (TTAN.IN/TITN.BO) is a premier specialised retail player in India. The company primarily operates in the Watches (top line contribution of 35% in FY07) and Jewellery segments (top line contribution of 62% in FY07) and Other businesses (top line contribution of 3% in FY07), which mainly constitutes Precision Engineering, Eyewear, etc. Titan has recently forayed into the Prescription Eyewear business as well. The company recorded a top line growth of 45% Y-o-Y to Rs.20.9 bn in FY07, which was driven by the Jewellery segment, up 66% Y-o-Y to Rs.12.9 bn and Watches segment, up 17.5% Y-o-Y to Rs.7.4 bn in FY07. ***As a result of a greater contribution from the Jewellery segment, which commands comparatively lower margins, and a rise in raw material costs, Titan recorded a decline of 120bps in its EBIDTA margin to 9.6% in FY07, as compared to 10.8% in FY06.***

Inventory days rise…although working capital cycle declines

Titan's inventory turnover period increased from 100 days in FY04 to 140 days in FY07, primarily due to its expansion in both the existing as well as new business segments. ***Titan expanded its jewellery product portfolio and launched its mass-jewellery under the 'Goldplus' stores and is in the process of scaling-up its operations in the studded jewellery space, which is a higher margin business than plain gold jewellery. It has also widened its watches portfolio by launching the 'Aviator series' and 'Fast Track' and increased its 'World of Titan' stores count to 211 in FY07, as compared to 188 stores in FY06.*** Titan has recently forayed into the Prescription Eyewear business under the *'Titan Eye+'* brand. Such expansion across business segments led to an increase in Titan's inventory, which management expects to rise further in line with the company's top line growth in the coming years. Inventory increased from 71% of capital employed in FY06 to 114% of capital employed in FY07.

Such expansion across business segments led to an increase in Titan's inventory, which management expects to rise further in line with the company's top line growth in the coming years

In line with the scaling-up of its operations, Titan witnessed greater bargaining power, which led to an increase in the creditors turnover period from 100 days in FY04 to 115 days in FY07. Moreover, the receivables turnover period continued to decline; it has gone down from 64 days in FY04 to 16 days in FY07, due to the company's revised collection policy.

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RoE declines…but still superior as compared to its peers

Titan recorded a decline in RoE, which was primarily on account of equity dilution and decline in operating margin in FY07. The company raised funds through a rights issue and non-convertible debentures in order to fuel its retail expansion and support its manufacturing base, as well as meet its working capital requirements in FY07. As a result, Titan recorded a RoE of 38.1% in FY07, as compared to 52.5% in FY06, which is still far superior compared to that of its peers. However, the company does not anticipate any further

Titan recorded a RoE of 38.1% in FY07, as compared to 52.5% in FY06, which is still far superior compared to that of its peers. However, the company does not anticipate any further fund raising as of now and expects the internal accruals to be sufficient for funding its working capital requirements in the coming years

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High working capital requirement & capex put pressure on free cash flows…

Titan's high working capital requirement led to a decline in its free cash flows in FY07. The company's expansion across business segments has resulted in a more than three fold rise in its working capital requirement, which offset the increase of 11.4% Y-o-Y in the gross cash flows. Moreover, Titan recorded an increase of 36% Y-o-Y in the net Capex due to the setting-up of a new watch assembly unit (assembling capacity of 2 mn watches per annum) at Roorkee (Uttaranchal) in FY07. The company also set up a new facility for manufacturing 1 mn case blanks per annum. Correspondingly, Titan's watch production capacity increased from 11 mn units in FY06 to 12 mn units in FY07. The rise in the company's working capital requirement and higher capex led to a decline of 93% Y-o-Y in the free cash flow from operations in FY07.

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Scaling-up of Jewellery operations & Precision Engineering to lead future growth…

Titan opened two pilot stores for its mass-jewellery initiative in Tamil Nadu and Madhya Pradesh and increased its store count to 10, following an encouraging response from its customers. The Jewellery segment has been performing well and grew by 66.2% Y-o-Y, on the back of a growth of 45% Y-o-Y in FY06, and contributed 62% to the top line in FY07. Although the Jewellery business commands comparatively lower margins, the company plans to increase the contribution of studded jewellery, which commands better margins and presently contributes 28% to the jewellery business. We believe that although the company's mass-jewellery business will aid its top line growth, the bottom line growth due to rise in mass-jewellery business, may not be that attractive on account of its low margins.

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Titan has also been performing well in the Precision Engineering business, which caters to the requirements of Automotive (51%), Aerospace (18%), Hydraulic (17%) and Medical and other segments and boasts of customers like Ford, Tata Motors, Toyota Tsusho, Jet Avion, Tyco Electronics, etc. Being a high-margin business, we believe that the scaling-up of operations in the Precision Engineering segment will aid the company's bottom line growth in the coming years.

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Barometer: What happened to the growth rates, margins, cash flows, returns…

Higher working capital and Capex eat into Free Cash Flows

Free Cash Flow Analysis

(YE March 31) (INR mn)	FY06	FY07	*% Y-o-Y Change*
EBIT	**1357**	**1742**	***28.3%***
Less: Adjusted taxes	207	496	
NOPLAT	**1150**	**1245**	***8.3%***
Add: Depreciation	197	256	***30.1%***
Gross cash flow	**1347**	**1501**	***11.4%***
Less: Increase in working capital	92	391	
Operating cash flow	**1255**	**1110**	***-11.6%***
Less: Net Capex	408	967	
Less: Increase in Net other assets	-103	75	
FCF From Operations	**951**	**67**	***-92.9%***

Source: Company reports, FG Estimates

Despite an increase of 28.3% Y-o-Y in the EBIT, Titan recorded a steep decline in the free cash flow from operations in FY07, primarily on account of a massive rise in its working capital requirement and capex. Titan recorded a more than three-fold rise in its working capital requirement, especially inventory, which increased by 81% Y-o-Y in FY07. An increase in the tax-outflow, which was primarily due to an increased contribution of jewellery business, which does not enjoy any tax-benefit, negated the EBIT growth and led to a marginal rise of 8.3% in NOPLAT in FY07.

Titan recorded a more than three-fold rise in its working capital requirement, especially inventory, which increased by 81% Y-o-Y in FY07. An increase in the tax-outflow, which was primarily due to an increased contribution of jewellery business, which does not enjoy any tax-benefit, negated the EBIT growth and led to a marginal rise of 8.3% in NOPLAT in FY07

Inventory increased to 32% of net sales in FY07, as compared to 26% of net sales in FY06. The higher-than-proportionate rise in inventory was partly due to an increase of 14% Y-o-Y in the gold prices from $582 per ounce in March '06 to $663 per ounce in March '07. Titan has expanded its operations both in the existing as well as new business segments. It had 211 *'World of Titan'* stores and 88 exclusive *'Tanishq'* stores in FY07, as compared to 180 *'World of Titan'* stores and 83 *'Tanishq'* stores in FY06. Moreover, the company has also expanded its operations in the mass-jewellery segment through its *'Goldplus'* stores and has opened 10 stores until now. The company recently forayed in the Prescription Eyewear segment as a pilot-project and has received an encouraging response. The increase in the company's retail presence led to a higher inventory level in FY07.

The net Capex increased by 36% Y-o-Y due to the setting-up of a new watch assembly unit (assembling capacity of 2 mn watches per annum) at Roorkee (Uttaranchal) in FY07. The company also set up a new facility of 1 mn case blanks per annum. Correspondingly, Titan's watch production capacity increased from 11 mn units in FY06 to 12 mn units in FY07. Such a rise in the company's working capital requirement and capex led to a decline of 93% Y-o-Y in the free cash flow from operations in FY07.

High asset turnover aids improvement in RoCE despite decline in operating margin

Calculation of Return on Capital Employed (RoCE)

(Year Ending March 31) (In %)	**FY06**	**FY07**
Raw Material % of Sales	63.1%	65.8%
Manufacturing Expenses % of Sales	1.0%	0.9%
Admin. Expenses % of Sales	3.2%	3.2%
Selling & Distribution Exp % of Sales	13.6%	12.6%
Personnel Exp as % of Sales	8.3%	8.0%
EBITDA % of Sales	10.8%	9.6%
Depreciation % of Sales	1.4%	1.2%
EBIT % of Sales (A)	**9.4%**	**8.3%**
Net Fixed Assets as % of Sales	12.3%	12.0%
CWIP as % of Sales	1.4%	0.8%
Net Working Capital as % of Sales	19.9%	14.0%
Capital Employed as % of Sales (B)	**36.4%**	**28.3%**
Pre-Tax RoCE (A)/(B)	25.9%	29.4%
Cash Tax Rate as % of EBIT	15.3%	28.5%
Operating RoCE*	**21.9%**	**21.0%**

Source: Company reports, FG Estimates *Note: *Adjusted for Excess cash and Investments*

Titan recorded a top line growth of 45% Y-o-Y to Rs.20.9 bn in FY07, as compared to Rs.14.4 bn in FY06, primarily driven by the Jewellery segment, which commands comparatively lower margin in comparison to the Watches segment. The Jewellery segment grew by 66% Y-o-Y to Rs.12.9 bn and contributed 62% to the top line, while the Watches segment grew by 17% Y-o-Y to Rs.7.4 bn and contributed 35% to the top line in FY07. On account of a greater contribution from the Jewellery segment, the raw material expenses increased, which led to a decline of 109bps in the EBIT margin to 8.3% in FY07, as compared to 9.4% in FY06. The rise in raw material expenses was partly due to a rise of 14% Y-o-Y in gold prices and also due to greater contribution from the jewellery segment in FY07.

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Despite the decline in the operating margin, an improvement in the asset turnover helped Titan record an increase of 350bps in the pre-tax RoCE to 29.4% in FY07, as compared to 25.9% in FY06. However, an increase in the contribution from jewellery business, which does not enjoy any tax benefits, Titan recorded an increase in the effective tax rate (as % of EBIT) from 15.3% in FY06 to 28.5% in FY07. ***Correspondingly, the post-tax RoCE declined 90bps to 21% in FY07, as compared to 21.9% in FY06***.

Revenue break-up: Jewellery segment leads the show

Geographical Distribution of Revenues

(Year Ending March 31) (INR mn)	FY06	FY07	*% Y-o-Y Change*
India	13,521	19,742	***46.0%***
% Contribution to Aggregate Revenue	93.9%	94.4%	
Europe	81	50	***-38.4%***
% Contribution to Aggregate Revenue	0.6%	0.2%	
Others	800	1,111	***38.9%***
% Contribution to Aggregate Revenue	5.6%	5.3%	
Aggregate Revenues	**14,402**	**20,902**	***45.1%***
Segmental Contribution of Revenues			
Time Products Segment	6,281	7,379	***17.5%***
% Contribution to Aggregate Revenue	*43.6%*	*35.3%*	
Jewellery Segment	7,763	12,898	***66.2%***
% Contribution to Aggregate Revenue	*53.9%*	*61.7%*	
Others Segment	358	625	***74.7%***
% Contribution to Aggregate Revenue	*2.5%*	*3.0%*	
Aggregate Revenues	**14,402**	**20,902**	***45.1%***

Source: Company Reports, FG estimates

Titan's revenues are primarily concentrated in the domestic market, which contributed 94%, while other markets, which include Singapore, Africa etc., contributed 5% to the top line in FY07. The company recorded a decline of 38% Y-o-Y in its revenues from the European market and plans to expand its jewellery operations in the US market in the coming years.

The Jewellery segment, which grew by 66.2% Y-o-Y contributed 62% to the top line, while the Watches segment, which grew by 17.5% Y-o-Y, contributed 35%, and Others, which primarily includes the Precision Engineering and Eyewear businesses, contributed to the rest of the top line in FY07. The contribution of the Jewellery segment, which commands comparatively lower margins, has been rising steadily since FY05.

Titan also has plans to further expand its jewellery portfolio and has already introduced mass-jewellery under its *'Goldplus'* stores. We believe that although expansion in the mass jewellery segment will aid the company's top line growth, the bottom line growth may be muted, as jewellery is a low-margin business. However, the company is taking steps to increase the contribution of studded jewellery (28% of the aggregate jewellery at present), which has comparatively better margins. Moreover, in order to maintain its bottom line growth, Titan has plans to increase its operations in the Precision Engineering segment (Others business segment), which commands much higher margins. The Other business segment grew by 75% Y-o-Y in FY07

Eagle Eye: What may otherwise be lost in the fine print…

Expansion across new & existing business segments leads to rise in inventory…

Titan's top line grew at a CAGR of 33%, while the profit after tax grew at a CAGR of 53% in FY04-07, although inventory grew at a CAGR of 60% over the same period. The higher-than-proportionate rise in inventory was partly due to a rise of 14% Y-o-Y in the gold prices, which increased from $582 per ounce in Mar '06 to $663 per ounce in Mar '07. Inventory grew at a CAGR of 60% in FY04-07; from 26% of sales in FY06 to 32% of sales in FY07. In line with this, inventories increased from 71% of capital employed in FY06 to 114% of capital employed in FY07.

The higher-than-proportionate rise in inventory was partly due to a rise of 14% Y-o-Y in the gold prices, which increased from $582 per ounce in Mar '06 to $663 per ounce in Mar '07. Inventory grew at a CAGR of 60% in FY04-07; from 26% of sales in FY06 to 32% of sales in FY07. In line with this, inventories increased from 71% of capital employed in FY06 to 114% of capital employed in FY07

The steep rise in inventory was offset by a decline in net loans & advances and receivables, which declined at a CAGR of 30% and 15% in FY04-07. The decline in loans & advances was primarily on account of lower advances to its subsidiaries and write-offs, while the decline in the company's receivables was due to an improved collection policy. The net aggregate loans & advances declined to 11% of capital employed in FY07, as compared to 27% of capital employed in FY06, while receivables declined to 16% of capital employed, as compared to 17% of capital employed in FY06. Correspondingly, the gross current assets grew at a CAGR of 18.4% in FY04-07.

On account of increased scale of operations, Titan enjoyed much greater bargaining power with its suppliers. In line with the rise in inventory, the company recorded a steep CAGR of 53% in creditors for FY04-07. Titan incorporated AS-15, which deals with employee benefits, which led to an increase in the provision for gratuities for the company's employees and resulted in higher contribution from provisions in FY07. Moreover, a higher provision for equity dividend also led to a rise in the company's provisions.

Common-sized Net Working Capital

(YE March 31) (In %)	FY04	FY05	FY06	FY07
Current Assets (A)	**145%**	**189%**	**225%**	**302%**
Inventories	44%	74%	101%	184%
Receivables	40%	26%	31%	31%
Loans & Advances	53%	58%	50%	22%
Cash & Bank	7%	15%	13%	17%
Less: Current Liabilities (B)	**45%**	**89%**	**125%**	**202%**
Payables	40%	82%	116%	181%
Provisions	4%	7%	9%	19%
Others	0%	0%	0%	1%
Net Working Capital (A)-(B)	**100%**	**100%**	**100%**	**100%**

Source: Company Reports, FG estimates

Titan has allocated most of its advances to its subsidiaries and associates for better inventory procurement and expansion in the international market, especially Europe. However, on account of certain slow moving inventory held by the associates and operating losses, the company recorded provision for such advances to its subsidiaries amounting to Rs.240 mn and Rs.250 mn in FY07 and FY06 respectively. Titan has initiated various steps in restructuring its overseas companies and expects this exercise to be completed during the current financial year and thus may not require any further provisioning.

Loans & Advances - Details

(INR mn)	FY04	FY05	FY06	FY07
Subsidiaries	1309	1253	1297	751
Others	787	944	868	870
Aggregate Loans & Advances	**2096**	**2197**	**2165**	**1621**
Less: Provision for doubtful advances	150	476	726	966
Net Aggregate Loans & Advances	**1946**	**1721**	**1440**	**655**

Source: Company Reports, FG estimates

Working capital cycle declines, but inventory days increase

Average Working Capital Cycle (in Days)

	FY04	FY05	FY06	FY07
Inventory Turnover Period	100	120	130	140
Debtors Turnover Period	64	36	21	16
Creditors Turnover Period	100	108	116	115
Net Working Capital cycle	**64**	**48**	**35**	**40**

Source: Company Reports, FG estimates

Although Titan recorded a decline in its net working capital cycle from 64 days in FY04 to 40 days in FY07, the inventory turnover period witnessed a steady rise from 100 days in FY04 to 140 days in FY07. The rise in the inventory turnover period was primarily on account of its expansion in existing as well as new business segments.

Titan expanded its operations into new business segments, such as Prescription Eyewear *(Titan Eye+)* and mass jewellery *(Goldplus)*, which led to increased working capital requirements. Moreover, the company also expanded its operations in its existing business segments ***(Watches and Jewellery)***. The company increased the *'World of Titan'* store count to 211 in FY07, as compared to 188 stores in FY06 and 88 exclusive *'Tanishq'* stores, as compared to 83 stores in FY06.

The scaling-up of its operations led to a significant increase in the company's bargaining power, which resulted in an increase in the creditors' turnover period from 100 days in FY04 to 115 days in FY07. The company pruned its collection policy, which led to a decline in the debtors' turnover period from as high as 64 days in FY04 to merely 16 days in FY07.

RoE declines, but still superior to its peers…

DuPont Analysis

(YE Mar 31)	**FY04**	**FY05**	**FY06**	**FY07**
EBITDA/Sales (%)	11.2%	11.4%	10.8%	9.6%
Sales/Operating Assets (x)	2.4	3.3	5.1	7.2
EBITDA/Operating Assets (%)	**26.6%**	**38.0%**	**54.9%**	**68.9%**
Operating Assets/Net Assets (x)	0.6	0.6	0.5	0.5
Net Earnings/EBITDA (%)	27.9%	42.9%	60.0%	53.6%
Net Assets/Net Worth (x)	5.0	4.1	3.0	2.0
Return On Equity (RoE) (%)	**21.7%**	**37.9%**	**52.5%**	**38.1%**

Source: Company Reports, FG estimates

Titan commands a superior RoE of 38.1% in FY07, primarily on account of its greater asset turnover. Despite equity dilution (2.1 mn shares @ Rs.350 through rights issue) and a decline in the EBIDTA margin, Titan managed to record a RoE of 38% in FY07. The decline in the EBIDTA margin was primarily on account of a rise in operating expenses, especially raw material costs.

Titan raised funds through a rights issue and non-convertible debentures in order to fuel its retail expansion and support its manufacturing base in FY07. Considering the company's track record and expansion plans across existing business segments, as well as simultaneous entry into new segments, we are optimistic over the company's performance in the coming years. We believe that although such dilution will impact the company's return ratio in the short run (though return ratios still remain better than that of its peers), the scaling-up of operations in the existing businesses, such as Watches and Jewellery, and new businesses, like Precision Engineering, which commands much higher margins, will aid the company's growth in the coming years.

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The funds raised through non-convertible debentures helped Titan repay some high-interest bearing debt and fund its working capital requirements in FY07. This led to a decline in leverage (debt-equity multiple of 0.8x in FY07, as compared to 1.4x in FY06), which resulted in a lower Net Assets/Net Worth multiple and Net Earnings/EBIDTA multiple in FY07. However, the management does not expect any further fund raising plan as of now and expects the internal accruals to be sufficient to fund its working capital requirements in the coming years.

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