Prabhudas Lilladher

Titan Industries

Focus on retail expansion

July 1, 2008

Rating	**Not Rated**
Price	Rs992
Target Price	NA
Implied Upside	NA
Sensex	13,462

(Prices as on June 30, 2008)

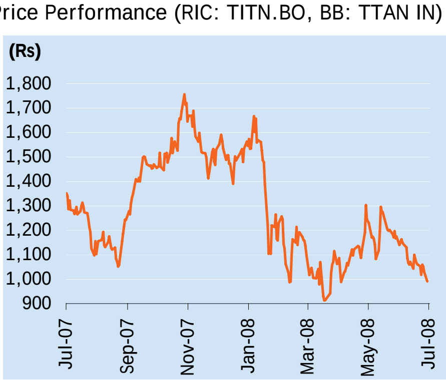
Trading Data	
Market Cap. (Rs bn)	44.0
Shares o/s (m)	44.4
Free Float	46.9%
3M Avg. Daily Vol ('000)	47.6
3M Avg. Daily Value (Rs m)	54.9

Major Shareholders	
Promoters	53.1%
Foreign	12.8%
Domestic Inst.	3.0%
Public & Others	31.1%

Stock Performance

(%)	1M	6M	12M
Absolute	(15.5)	(36.5)	(26.0)
Relative	2.5	(2.9)	(17.8)

Price Performance (RIC: TITN.BO, BB: TTAN IN)



Source: Bloomberg

- **Positive outlook:** Titan Industries' management remains positive on both its key businesses – watches and jewellery. The company believes innovation, new product collections and retail expansion supported by the brand equity created in both its flagship brands *Titan* and *Tanishq* would help in continued growth.
- **Watches:** The company expects 25% sales growth in watches with 20% volume growth, and 4-5% price increase and 30% volume growth in gold jewellery business.
- **Jewellery:** However, the expansion of its mass market jewellery *Gold Plus* stores could exert pressure on margins, but high growth estimated at (about 50%) in studded jewellery may compensate for the same.
- **Eyewear:** Titan has identified prescription eyewear as a third business with good potential in organised retailing due to lack of transparent pricing and high margins. The company has an advantage in that space which is a personal accessory with its trusted image, transparent price offering and scope of providing standard experience with expanded reach.
- **Precision engineering:** Has remained a stable opportunity in the automotive, defence and aerospace segments. The company has targeted to grow this business to Rs800m by FY08-09.
- **Valuation:** Collectively, the company is targeting an annual turnover of Rs40bn in FY09 and over Rs50bn in FY10. At the CMP of Rs992 , the stock is trading at 27.8x FY08.

Key financials (Y/e March)	FY05	FY06	FY07	FY08
Revenue (Rs m)	10,967	14,402	20,902	29,937
Growth (%)	*22.6*	*31.3*	*45.1*	*43.2*
EBITDA (Rs m)	857	1,358	1,757	2,504
PAT (Rs m)	329	813	956	1,583
EPS (Rs)	7.8	19.2	21.5	35.7
Growth (%)	*51.1*	*147.3*	*12.0*	*65.5*
Net DPS (Rs)	2.0	3.1	5.0	8.0

Source: Company Data; PL Research

Profitability & valuation	FY05	FY06	FY07	FY08
EBITDA margin (%)	*7.8*	*9.4*	*8.4*	*8.4*
RoE (%)	*19.2*	*39.7*	*34.2*	*41.5*
RoCE (%)	*10.6*	*19.6*	*19.8*	*26.5*
EV / sales (x)	4.1	3.1	2.2	1.5
EV / EBITDA (x)	52.1	32.6	26.2	18.4
PE (x)	127.4	51.5	46.0	27.8
P / BV (x)	23.7	18.0	13.4	10.1
Net dividend yield (%)	*0.2*	*0.3*	*0.5*	*0.8*

Source: Company Data; PL Research

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Management representatives:
Mr. Bhaskar Bhat, Managing Director
Ms. Usha Iyengar, Company Secretary

Q: Could you throw some light on Titan's various businesses and their performance?

A: We are primarily engaged in manufacturing and marketing of watches and jewellery, which accounted for about 30% and 65% respectively of our total revenue in FY08. Additionally, we are engaged in businesses like precision engineering, fashion eyewear, and have also forayed into prescription eyewear. We enjoy leadership in two of our major businesses, watches and jewellery.

In watches, we are the fifth largest own brand manufacturer cum retailer in the world, with major presence in the mid upper and mass market through our brands like *Titan, Sonata* and *Fastrack*. We are present in the premium watch category through the launch of *Xylys*. Our watches business has grown by about 12%-14% CAGR during the last six years to Rs8,800m against the market growth of about 8%-10% per annum. Our watches volume crossed 10 million in FY08, with *Sonata* selling five million watches and *Fastrack*, the fastest growing youth brand, selling one million watches.

In the branded jewellery business, we are the significant/large player in India. Our branded jewellery business is primarily operated under the brand name, *Tanishq* and *Gold Plus*. *Tanishq* has grown at a strong rate of about 40% CAGR in the past six years to Rs18bn. *Gold Plus*, our new venture, is primarily targeted at the semi-urban and rural market that is highly value conscious and prefer traditional jewellery. Hence, a new business model and a new brand to exploit this opportunity. *Gold Plus* clocked sales of Rs950m in FY07 and Rs2,000m in FY08.

In watches, our PBIT margin is in the mid teens; while in jewellery, we currently enjoy a PBIT margin of about 5%-7% depending upon the product mix, viz. plain gold and studded jewellery.

In the precision engineering business, our company manufactures precision components primarily for automotives, aerospace and medical applications. This division recorded a turnover of about Rs500m in FY07.

We commenced the eyewear business in 2004-05 by marketing sunglasses under the *Fastrack* brand, which is targeted at the youth segment. The segment achieved a sales turnover of over Rs250m in FY07 and Rs400m in FY08. Our new foray for prescription eyewear, *Titan Eye+* started in Q4FY07. We wish to enter as a branded retail chain of standalone stores with our brands in frames. We have opened 10 *Titan Eye+* outlets as on March 31, 2008, achieving sales of Rs100m.

Q: What are the various watch brands we have and how is their growth? What have been the key growth drivers in your watches division and what is your outlook on the business going forward?

A: Our watches business has been growing at about 12-14% CAGR in the last six years against the industry growth of 8-10% per annum. We recently crossed production of 10 million watches per annum.

The Indian watch industry is worth about Rs27bn, of which about 44% is at the lower end, where we have our presence with the *Sonata*. The volume of *Sonata* watches crossed five million. Competition in this segment is from *HMT* and *Maxima* and from grey market players.

The mid-end market is about 30% of the overall market, where we share a dominant position with our flagship brand, *Titan*.

Between the two segments, we have our youth brand *Fastrack*, which crossed one million watches.

At the mid premium end, which constitutes about 15% of the market and is growing fast about 30%, we have introduced *Octane, Xylys, Nebula*, besides our franchised brands *Hugo Boss* and *Tommy Hilfiger*. This segment has also helped in changing consumers' mindset about watch prices.

Our growth can be attributed to our unparalleled reach and extended product offerings. We have about 10,000 dealers spread across 2,300 towns, 236 World of Titan showrooms in 116 towns, and our watches are also sold through 117 multi-brand stores across 73 towns. This is further backed by 751 service centres in 348 towns. Also our product offerings across different price points have aided growth. Our watch sales have also been backed by strong sales growth in its retail chain of World of Titan and large format stores.

Retail sales of our *Titan* brand is growing at about 25% to 30% a year. These exclusive retail stores are more profitable than the dealers' network, as our stores command higher margins and stock a richer product mix. As the strategy is to increase the customer access as watches are becoming impulse purchases, we plan to increase the number of exclusive stores in our distribution channel. We are expecting to pilot a new retail format in which we will sell premium products not only from our stock but other brands as well.

Going forward, led by innovation and higher number of retail outlets, we plan to increase our volume by 20% in FY09. Moreover, the price increase which we have already taken in some ranges (about 4-5%) would result in about 25% sales growth in FY09. This should also help in improving our margins.

Q: What is the penetration level of watches in India and where does *Titan* stand in the scheme of things?

A: In India, watches have an overall penetration of about 27%. South is the largest in terms of proportion at 32% and east the smallest at 20%.

Q: What is the current product mix of *Titan*'s jewellery business and what are the profit margins related to these products?

A: Sales at our *Tanishq* stores comprise about 27% of diamond/colour stone-studded jewellery and about 72% of gold jewellery. Diamond-studded jewellery is growing by over 50%, and plain gold jewellery at about 15-20%. The overall margin in the business is about 6%.

Q: Are we experiencing any slowdown w.r.t. to the higher price? Do we see any competition building up and any impact from them?

A: We have seen consumer reluctance in buying gold jewellery during *Dhanteras*, they'd rather buy gold coins. Similarly, during *Akshay Tritiya*, we have seen growth in sales. However, if gold prices shoot up high, the demand may be sluggish and may shift towards diamond jewellery. We are gearing ourselves to meet the increase in diamond demand, and it would be good as it provides us higher margins.

However, the brand equity which we have built in *Tanishq* should provide us the competitive edge. As a market leader, one should have minimum of 10% and we see good growth potential for us even if the market witnesses a slowdown.

New players are entering organised jewellery retailing, and we see an opportunity as more players would precipitate the shift from unorganised market to organised retailing.

Q: What have been the key drivers of growth in *Titan*'s jewellery business?

A: We have seen strong growth of about 40%-45% CAGR in jewellery sales, primarily from the gain in share from unorganised jewellery players. This has risen from better (purer) gold and design differentiation. The movement towards regulated brands due to purer metal and differentiated designs happens on a small scale but is taking place very rapidly. Also we are seeing a trend of preference in *Tanishq* jewellery against local jewellery as the price of gold increases. At high gold prices, people prefer to buy purer gold. We have seen 57% growth in sales with 30% same stores sales growth and 30% volume growth.

Q: What would be your asset turnover in the jewellery business, and whether the higher RoCE in the business is sustainable?

A: We believe that the RoCE of over 50% in FY08 in the business is sustainable through volume growth in the same stores and a consequent high asset turnover.

Q: What are your plans with regards to the US market?

A: Jewellery market in the US is the largest in the world. In July 2008 we will open our first store in Chicago and launch *Tanishq* in the US markets. We will be opening our second store in New Jersey in October 2008. We are currently looking for space in a mall, and our target audience is not only the Indian diaspora but also the mainstream American population looking for different product designs and value for money.

Q: How do you account for gold used in the jewellery business?

A: Bankers fund the gold used in our jewellery business, and we in turn account for the same as gold on loan from banks. Thus the cost related to the same is limited to the sub-libor interest paid on the value of the gold funded by banks. The gold on loan appears in current liabilities of our balance sheet.

Q: What is the average size of a *Tanishq* store and what would be the rent for the same?

A: The size of an average *Tanishq* store is 3,000 sq.ft., thus aggregating to a total space of about 220,000 sq.ft. for the complete chain. For an outlet that has been in existence for about ten to twelve years, rent is about 2–3% of sales. For a new outlet, rent is about 4%-5% of sales.

Q: Could you provide details on your *Gold Plus* model?

A: *Gold Plus* deals in gold jewellery, through smaller stores catering mainly to the semi-urban and rural markets, where *Tanishq* is absent. As it is located in smaller towns and rural markets, the cost of operating a *Gold Plus* store is relatively low due to the lower cost of property and labour.

In *Gold Plus* stores, plain gold is expected to make up 95% of sales. Our margins of about 3% arise from making charges for gold jewellery based on the grammage sold. The *Gold Plus* chain has achieved breakeven during FY07. The return on capital employed (RoCE) in the business is currently about 25%.

Q: What were the reasons for the dismal growth in Q3FY08?

A: The reasons for our jewellery division's PBIT falling in Q3FY08 as compared to Q3FY07 are:

- The increase in the gold price, which in turn resulted in:
  - reduced sales relative to our budget, resulting in higher closing stocks
  - inflation of the value of sales
  - reduced margins due to unchanged "making charges"
  - reduced margins due to increased sales under exchange schemes

- a deficit from hedging operations, primarily due to gold price volatility
- a deficit from application of Accounting Standard 11 due to high closing stocks

- Increased overheads

The company has taken some of the following steps to mitigate these factors:

- Under exchange scheme, gold price is at market price against earlier repurchase price at a premium to the market rate of about 5% of market gold price (same as what we charge on selling)
- Linked making charges to percentage of gold price from absolute making charges charged earlier
- Striving to take 100% of gold on lease

Q: What would be the size of the domestic prescription eyewear industry and what are your plans regarding *Titan Eye+* (the eyewear business)?

A: The Indian eyewear market is about Rs15-18bn, comprising volumes of about 25-30 million units a year. The potential in the eyewear market can be seen from the fact that about 30% of the population (300 million people) need correction in vision, and at 84 million, only 25% of the given population uses eyewear.

We plan to open about 150 stores in the next three years and aim at a turnover Rs15m per store. At present, we have about ten *Titan Eye+* stores. The smallest, at about 1,200 sq.ft., the largest, at about 2,400 sq.ft.,

Q: What would be the profitability in the prescription eyewear business?

A: Margins in the eyewear business are similar to the margins in watches. PBIT margin in the eyewear business could thus be in the range of about 8%-10%. We believe that profitability in eyewear would further improve with greater volume and scale, and sales per store growing steadily over a period of three to five years.

Q: Finally, where do you see *Titan* in the next three years?

A: By FY10, we want to be a billion dollar company. We are targeting at revenue of Rs46.7bn from Rs21.7bn in FY07. Watches would contribute about Rs13bn, while jewellery is expected to contribute about Rs21bn to our FY10 turnover. Our new initiatives like precision engineering, prescription eyewear and *Gold Plus* would contribute about Rs11bn to our total turnover in FY10.

Q: What are your growth plans in the retail segment, and can the retail expansion be linked to growth in sales?

A: For retail expansion, capex planned is Rs700m of a total capex of about Rs1bn. Capex is primarily for deposits for rentals and interior of stores. Most of these stores are under long-term leases; very few are actually owned by us. During FY09, we have planned the following expansions in retail and we do believe from our past experience that this retail expansion could be highly co-related to growth in volumes, particularly in watches.

Expansion planned during FY09

No. of outlets	FY07	FY08	FY09E
World of Titan	207	236	316
Sonata		14	14
Time Zone		117	0
Fastrack			50
Tanishq	88	106	121 +2 (US)
Gold Plus	10	22	35
Titan Eye+	1	10	80
Watch Care Centres		135	135
Luxury Retail			Maiden store with premium licensed brands besides stocking high end Titan & Xylys watches

Source: Company Data, PL Research

Q: What would be the expected margin in FY09?

A: We expect our jewellery margins to be maintained with *Gold Plus* expansion putting pressure on margins, while growth of studded jewellery compensating for any loss in margin. We believe our watches' margin could improve this year, while eyewear margin will breakeven in FY10. Overall, we expect our margin to remain flat in FY09.

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PL's Recommendation Nomenclature

BUY	:	> 15% Outperformance to BSE Sensex	**Outperformer** (OP)	:	5 to 15% Outperformance to Sensex
Market Performer (MP)	:	-5 to 5% of Sensex Movement	**Underperformer** (UP)	:	-5 to -15% of Underperformace to Sensex
Sell	:	<-15% Relative to Sensex			
Not Rated (NR)	:	No specific call on the stock	**Under Review** (UR)	:	Rating likely to change shortly