

April 6, 2010

ACCUMULATE

Price	Target Price
Rs1,871	Rs2,080
Sensex	17,941

Price Performance

(%)	1M	3M	6M	12M
Absolute	2	32	50	130
Rel. to Sensex	(3)	28	41	33

Source: Capitaline

Stock Details

Sector	Retail
Reuters	TITN.BO
Bloomberg	TTAN@IN
Equity Capital (Rs mn)	444
Face Value (Rs)	10
No of shares o/s (mn)	44
52 Week H/L (Rs)	1,905/718
Market Cap (Rs bn/USD mn)	83/1,865
Daily Avg Vol (No of shares)	113387
Daily Avg Turnover (US\$ mn)	4.4

Shareholding Pattern (%)

	D'09	S'09	J'09
Promoters	53.1	53.1	53.1
FII/NRI	11.2	10.6	10.2
Institutions	8.7	8.8	9.0
Private Corp	3.3	3.9	4.3
Public	23.8	23.7	23.5

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Luster Finish, Upgrade to 'ACCUMULATE'

We did a conference call with the management of Titan Industries (Titan) to get status update on the business environment and strategies deployed to accentuate the growth momentum. We are excited by more enabling environment versus recent past and growth initiatives undertaken by the company. We upgrade our rating from 'HOLD' to 'ACCUMULATE'.

Sharp increase in gold prices, unfavourable business environment and negative consumer sentiments dented Titan's 9MFY10 Jewellery business growth traction. Nevertheless, conditions have improved significantly - with stabilization of gold prices, better acceptance of gold prices by consumers and changing consumer sentiments. In addition, Titan has entered in a favourable base effect in jewellery business - which would be beneficial for next 3-4 quarters. Furthermore, down trading in watch business is expected to come to halt - with expectation of all-round growth in watches portfolio. Titan's restructuring and right sizing exercise in the eyewear business is likely to augur well for the business in the long run. There are few welcome surprises (1) reduction in capital expenditure, thereby easing cash flow and (2) reduction of capital employed, owing to reduction in working capital. We fine tune our earnings estimates factoring for above changes. Consequently, we upgrade our FY10E and FY11E earnings estimates by 10% (Rs48.1/Share to Rs52.1/Share) and 9% (Rs60.8/Share to Rs65.2/Share) respectively. We introduce our FY12E earnings estimates of Rs79.6/Share.

Considering (1) enabling business environment, (2) favourable base effect for next 3-4 quarters and (3) relatively lower risks to the earnings estimates – we are rolling our valuations on FY12E earnings. Titan's historical valuations stands at – 5-year average PER of 25X, 2-year average PER of 25X and rolling 1-year average is 26X. We have valued the company at near term average of 26X – on its FY12E earnings. Consequently, we revise our price target from Rs1763/Share to Rs2080/Share and upgrade our rating from 'HOLD' to 'ACCUMULATE'.

Jewellery business is eyeing good times ahead- benefiting by favorable base effect and stabilization of gold price

- Huge surge in gold prices beginning November 2008 resulted in volume declines for 4 consequent quarters. Titan recorded volume decline of 15%, 10% and 4% in Q1FY10, Q2FY10 and Q3FY10 respectively
- Business environment has improved beginning Q3FY10 with stabilization of gold prices and better acceptance by customers
- Tanishq recorded lower volume decline at 5% and 3% in October 2009 and November 2009 respectively. Whereas, volumes grew double digit in December 2009 reversing the 12 month trend of volume decline.
- Studded jewellery recorded 85% jump in volumes in last 3 years - which is positive for the company. However, contribution to total revenues declined from 33% to 30% primarily due to rise in gold prices
- Company expects the gradual shift to continue – and high margin studded jewellery is expected to increase from current 30% to 40% of jewellery business. Margins in studded jewellery is 2.5X plain gold jewellery
- Rise in customs and excise duty on gold is a complete pass through to customers – hence not likely to impact jewellery business performance

Financial Snapshot (In Rs Mn)

	Net Sales	EBITDA (Core)	EBITDA (%)	AEPS APAT	EV/ EBITDA	P/BV	Div Yld (%)	RoCE (%)	P/E	
FY2009	38,034	3,371	8.9	2,100	47.3	25.0	15.1	0.5	41.6	39.6
FY2010E	46,463	3,674	7.9	2,314	52.1	22.9	10.9	0.5	39.9	35.9
FY2011E	53,747	4,524	8.4	2,894	65.2	18.3	8.3	0.5	39.3	28.7
FY2012E	63,639	5,438	8.5	3,532	79.6	14.9	6.4	0.5	38.8	23.5

Impact on Q4FY10E estimates – Volume growth momentum of December 2009 is most likely to continue in Q4FY10E – thanks to favourable base effect and better acceptance of higher gold prices

Impact on FY11E estimates – Company expects FY11E to be far better than FY10E on both volumes and operational performance. The key reasons are - (1) improved consumer sentiments (2) stabilization of gold prices (3) acceptance of gold prices and (4) favourable base effects for next 4 quarters.

Watch business – down trading to halt in FY10E and eyeing better times in FY11E

- Down trading was prevalent in 9MFY10. Though, Titan recorded volume growth in watch business, the growth was at expense of premium brands “Fast track” and “Titan”. Consequently, operating margins declined from 19.9% in Q2FY09 to 14.7% in Q3FY10
- Most likely the down trading will halt in ensuing quarters- with expectation of all-round growth in watches portfolio. Also, the period of unfavorable base effect will end beginning Q1FY11E.
- Rural markets were key contributor to growth momentum and urban markets reported a muted off-take - consequently ‘Sonata’ reported better growth versus ‘Titan’ and ‘Fast track’. But, improving consumer sentiments especially in Urban India will improve the volume growth profile
- New designs and new launches are the cornerstone of success and continued growth momentum of the watches business. Expect to continue this strategy and launch new collections every quarter
- Titan expects to report 8 -10% volume growth on sustainable basis in the watches business. Wherein, premium segment is expected to grow at 20% and mass segment is expected to grow at 15-20%. The challenge is to grow the middle or economy segment (which includes Sonata) expected to grow less than 10%
- Current increase in excise duty is not likely to impact the business – since Titan produces 2/3rd of its watches at the excise free location. For the rest, Titan is planning to take blended price hikes of 2-3% beginning Q1FY11E to offset the rise in excise duty

Impact on Q4FY10E estimates – Status quo on watches business- growth momentum to continue in the last quarter. This is despite less wedding days in Q4FY10E

Impact on FY11E estimates – Enabling business environment is expected in FY11E led by (1) improving consumer sentiment and (2) resurgence of premium brands led by urban consumption. We reiterate our volume growth and value growth estimates of 9.0% and 10.9% in FY11E.

Others – Precision engineering is likely to show improvement in FY11E

- Precision engineering business was impacted due to (1) slow down in export business- especially flowing from USA and (2) muted order inflow from domestic market
- After reporting EBIT of Rs10 mn in FY09, Precision engineering is likely to report EBIT loss in FY10E. Company expects the business to turnaround in FY11E with EBIT of Rs10 mn – yet again similar to FY09 levels.

Impact on Q4FY10E estimates – No improvement expected in Q4FY10E- with business expected to report muted revenue performance accompanied with EBIT loss.

Impact on FY11E estimates – With expected buoyancy in private capex in domestic market and resurgence of activity in international market- the division will retrace to FY09 levels in terms of revenue and profitability.

Other - Eyewear Business – emerge stronger after the restructuring exercise

- Already right sized and restructured the business operations in Q2FY10 – closed 10 large format stores in last 4 months.
- Plans to have two-pronged store format – few large stores in key commercial district with area of 1200-2000 sq. ft. and small feeder stores of 600-800 sq. ft. This is likely to reduce break even time for the business
- Company incurred restructuring expense of Rs60 mn – 75% of which is already provided in 9MFY10. There are no other costs related to restructuring
- Owing to restructuring, company will fall short of its store expansion plans in FY10E. Expect to have network of 90 store in Eye-Plus by April 2010 against 100 stores in March 2010
- Company restricted the EBIT loss to FY09 levels - owing to no expansion to store network. But, EBIT loss is likely to increase in FY11E with expansion in store network
- Titan reiterates its expansion targets - open 30-35 Eye-Plus stores every year

Impact on Q4FY10E estimates – Q4FY10E will not be materially different from the Q3FY10. The division will continue to report muted revenue growth and EBIT loss in Q4FY10E.

Impact on FY11E estimates – Though, Titan management expects that Eyewear would break even in FY12E - we are not optimistic on the same. We believe that, breakeven would be longer than anticipated in Eyewear business.

One offs in FY10 performance - likely to even out in FY11E

- Jewellery business operates on cost plus percentage basis- implies that inflationary scenario in raw materials is always beneficial. Company benefited from the rise in gold prices throughout FY10E- reporting abnormal spurt in EBIT margins. This is likely to even out in subsequent quarters – with margins likely to trend down in FY11E.
- Stock out scenario is uncommon in manufacturing business – but was prevalent for Titan in FY10E. All thanks to unanticipated buoyancy and non-planned demand in watches and jewellery leading to stock-out situation. This translated into reduction of capital employed in business owing to reduction in working capital. We tag these as one-off events and expect restocking in FY11E and resultant increase in capital employed in forthcoming year.

Minor changes in capital expenditure – reduced the capital expenditure in FY10E

Company has curtailed the expansion plans for FY10E – setting up lesser-than targeted stores for Eye Plus and Tanishq. Infact, company has not added stores in jewellery business – against targeted expansion of 15-20 stores. Further, the eye-plus expansion was put on hold in Q2FY10 - owing to ongoing restructuring of retail operations. Consequently, FY10E capex is revised downwards from Rs0.4 bn to Rs0.3 bn, but maintain the FY11E capex of Rs0.4 bn.

	Number of retail stores		
	FY09	FY10E	FY11E
Jewellery			
Tanishq	115	115	125
Gold Plus	30	29	30-35
Zoya	2	2	2
Watches			
World of Titan	265	295	325-330
Fast Track	4	20	50
Helios	1	1	3-5
Eye wear			
Titan Eye+	69	87	130-150

Fine tuning our estimates – to factor for base effects and improved business environment

Based on interaction with Titan management – we forecast more enabling environment for the jewellery and watches business. Also, jewellery business is entering a favorable base effect – which would have profound impact on the performance of forthcoming quarters. There are few welcome surprises like (1) reduction in capital expenditure, thereby easing cash flow and (2) reduction of capital employed, owing to reduction in working capital. We fine tune our earnings estimates factoring for above changes. Consequently, we upgrade our FY10E and FY11E earnings estimates by 10% (Rs48.1/Share to Rs52.1/Share) and 9% (Rs60.8/Share to Rs65.2/Share) respectively. We introduce our FY12E earnings estimates of Rs79.6/Share.

Upgrade to 'ACCUMULATE', revise price target from Rs1763/Share to Rs2080/Share

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Financials

Income Statement

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
Net Sales	38,034	46,463	53,747	63,639
Growth	27.0	22.2	15.7	18.4
Expenses	34,663	42,789	49,223	58,201
Growth	25.8	23.4	15.0	18.2
Raw Materials	26,917	33,459	38,601	45,294
% Of Sales	70.8	72.0	71.8	71.2
Employee Cost	2,334	2,680	2,989	3,329
% Of Sales	6.1	5.8	5.6	5.2
Manufacturing Expenses	969	1,184	1,370	1,940
% Of Sales	2.5	2.5	2.5	3.0
Admin Expenses	1,039	1,039	1,143	1,258
% Of Sales	2.7	2.2	2.1	2.0
Selling & Distribn Expenses	3,623	4,426	5,120	6,380
% Of Sales	9.5	9.5	9.5	10.0
Ebidta	3,371	3,674	4,524	5,438
Growth	41.0	9.0	23.2	20.2
Ebidta%	0.1	0.1	0.1	0.1
Other Income	53	89	89	89
Interest	294	218	250	265
Depreciation	418	357	377	397
PBT	2,707	3,188	3,987	4,866
Tax	607	874	1,093	1,334
PAT (Before EO Item)	2,100	2,314	2,894	3,532
Growth	31.1	10.2	25.1	22.0
Net Margin%	0.1	0.0	0.1	0.1
E/O Item	511	-300	0	0
Reported PAT	1,590	2,614	2,894	3,532

CashFlow Statement

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
Pre-Tax Profit	2,306	3,488	3,987	4,866
Depreciation & Non Cash	426	357	377	397
Interest & others	1,372	218	250	265
Chg in W Cap	-909	-2,019	-1,046	-1,443
Tax Paid	-593	-874	-1,093	-1,334
Operating CashFlow	2,601	1,170	2,475	2,751
Capex	-445	-311	-356	-356
Free Cash Flow	2,156	859	2,119	2,395
Investments	7	0	0	0
Equity Capital	0	0	0	0
Loans	-383	0	0	-528
Dividend	-353	-519	-519	-519
Others	217	-218	-250	-265
Net Change in Cash	1,644	122	1,351	1,082
Opening Cash Position	519	547	669	2,019
Closing Cash Position	547	669	2,019	3,101

Balance Sheet

Y/E, Mar (Rs. mn)	FY09	FY10E	FY11E	FY12E
Equity Share Capital	444	444	444	444
Reserves	5,069	7,163	9,538	12,551
Networth	5,512	7,607	9,982	12,995
Suecured Loans	1,168	1,168	1,168	639
Unsecured Loans	587	587	587	587
Loan Funds	1,754	1,754	1,754	1,226
Total Liabilities	7,266	9,361	11,736	14,220
Gross Block	5,930	6,336	6,692	7,048
Less: Accumulated Depreciation	3,186	3,543	3,920	4,317
Net Block	2,745	2,794	2,773	2,731
Capital Work In Progress	195	100	100	100
Investments	77	77	77	77
Current Assets	14,777	18,074	22,059	26,801
Inventories	12,027	14,686	16,895	19,976
Debtors	1,062	1,325	1,532	1,814
Cash&Bank	547	669	2,019	3,101
Loans&Advances	1,141	1,394	1,613	1,909
Current Liabilities & Prov	10,346	11,501	13,090	15,307
Net Current Assets	4,432	6,572	8,969	11,494
Miscellaneous Expenditure	0	0	0	0
Deferred Tax	-182	-182	-182	-182
Total Assets	7,266	9,361	11,736	14,220

Key Ratios

Y/E, Mar	FY09	FY10E	FY11E	FY12E
Profitability %				
Ebidta Mgn	8.9	7.9	8.4	8.5
PAT Mgn	5.5	5.0	5.4	5.5
ROCE	41.6	39.9	39.3	38.8
ROE	42.5	35.3	32.9	30.7
Per Share Data (Rs/share)				
EPS	47.3	52.1	65.2	79.6
CEPS	56.7	60.2	73.7	88.5
BVPS	124.2	171.4	224.9	292.7
DVPS	10.0	10.0	10.0	10.0
Valuations (X)				
PER	39.6	35.9	28.7	23.5
CPER	33.0	31.1	25.4	21.2
P/BV	15.1	10.9	8.3	6.4
Ev/Sales	2.2	1.8	1.5	1.3
Ev/Ebidta	25.0	22.9	18.3	14.9
Dividend Yield	0.5	0.5	0.5	0.5
Turnover (X Days)				
Debtor TO	9.7	10.4	10.4	10.4
Inventory TO	117.1	125.3	125.3	125.3
Gearing Ratio (X)				
Net Debt/Equity	0.2	0.1	0.0	-0.1
Total Debt/Equity	0.3	0.2	0.2	0.1

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