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BSE Sensex: 13,928

Titan Industries

Rs 953
OUTPERFORMER

RESULT NOTE

Mkt Cap: Rs40.3bn; US$963m

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Result: FY07
Comment: Time's right!
Last report: 29 January 2007 (Price Rs943; Recommendation: Outperformer)

Key valuation metrics

Year end Mar 31 (Rs m)	Net Sales	yoy chg (%)	Net profit	EPS (Rs)	yoy chg (%)	EV / E	PER (x)
FY06	14,396	33.4	997	21.8	74.8	29.0	43.2
FY07	20,902	45.2	926	20.9	(4.5)	23.0	45.7
FY08E	26,865	28.5	1,607	36.2	73.6	16.5	26.3
FY09E	30,944	15.2	2,141	48.2	33.2	13.0	19.8

Titan Industries' (Titan) has registered a sharp revenue growth of 45% to Rs20.9bn in FY07, driven by 64% growth in jewelry business and 20% in the watches business. As the revenue mix moved in favour of relatively lower margin jewelry operations, EBITDA margins dipped by 120bp to 9.5%. PAT (pre contingencies of Rs240m) has grown by 18%. Contingencies include write off of design rights (Rs76m), interest cost adjustment (Rs45m) and valuation adjustments of overseas subsidiaries (Rs130m).

Product innovation (in watches & jewelry), rapid scale up of retail operations and addition of new avenues like eye-care and precision engineering, will continue to aid top-line growth. We expect the watch business to grow at ~15% and the jewelry business to grow at ~25% as consumers move towards organized shopping and Titan scales up its retail operations (240 *World of Titan* showrooms, 98 *Tanishq* and 25 *Gold Plus* stores by end of FY08). Titan has also forayed into prescription eyewear market (Rs25-30bn business) through its brand – Titan Eye+ and has plans to reach 15 stores by end of FY08. Titan's precision engineering business is expected to grow at ~80% CAGR over the next three years. While growth will be driven by multiple avenues, margins will expand on the back of favourable product mix – Titan over Sonata, studded jewelry over pure gold jewelry and growth of high margin precision engineering and eyewear retailing businesses. Titan currently trades at valuations of 19.8x FY09E earnings, 13.0x EV/EBITDA, 1.4x EV/Sales. Maintain Outperformer with a price target of Rs1,100.

HIGHLIGHTS OF FY07 RESULTS

❑ Continued growth momentum – driven by jewelry

Titan has reported a steep revenue surge of 45% in FY07 to Rs20.9bn on the back of continued momentum in watches and significant growth in the jewelry business. While the watches portfolio has grown at 20%, the key growth contributor has been the 64% growth in jewelry operations. Jewelry operations have gained from both – increasing gold prices and a 30% growth in offtake. Titan's precision engineering business has grown at ~80% in FY07 and has a strong order book from the automotive and aerospace industries.

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❑ Margins dip – faster growing jewelry business and investment mode

The rise in commodity prices and the increased contribution of the low margin jewelry business has affected margin growth and operating margins in FY07 (9.5%) are 120 basis points lower than FY06 (10.7%). Jewelry business reported EBIT margins of 6.6%, while watches operated at 14.26% margins. EBITDA margins have also dipped as Titan continues to be seed the precision engineering business (Rs112m losses at the EBIT level) and adds new stores in watches segment. We expect margins to improve in the long run on the back of product mix improvement within segments (Titan over Sonata, studded jewelry over gold jewelry), and the increased contribution of high margin businesses like precision engineering and eyewear. However, the investments that will be required to fund new ventures will restrict margin expansion in the short-term.

Cost Structure

(%)	FY07	FY06
Revenues (Rs m)	20,902	14,396
Material Cost	65.9	63.8
Staff Cost	7.5	7.4
Advertising	6.4	7.0
VRS	0.5	0.7
Other Expenditure	10.2	9.8

Source: Company

❑ Profit growth subdued – Contingencies of Rs240m

The net profit is lower at Rs926m (compared to Rs997m in FY06) primarily on account of a one-time contingency provision of Rs240m. Titan has provided for one time write off of residual design rights to the tune of Rs76m in the overseas operations. As per transfer pricing regulations, Titan also provided for Rs45m as interest cost towards loans to its overseas subsidiaries. Titan has also written off ~Rs130m towards valuation adjustment of overseas marketing companies (Dubai and Singapore) that it had transferred in 2004.

❑ Growth to continue

With a stable of strong brands, scaling up of retail operations and importantly product innovation in watches and jewelry business, we expect the growth momentum to continue. While new ventures like precision engineering are a small part of the operations today, going forward we expect it to contribute significantly to revenue and profit growth. We are confident of Titan's ability to pioneer new businesses and like its aggressive approach.

Watches –product innovation is the key

We expect Titan's watch business to grow at a steady pace (~15%), with value growth coming from product innovation at the top-end and volume growth coming from a wider distribution network. With only 30% penetration, there is still opportunity available in the watch market (especially low end, high volume) for Titan to capitalize on. Titan continues to expand its retail network and will have 240 *World of Titan* showrooms in FY08 from the current ~208 showrooms. We also believe that with an increasing tilt towards Titan (from Sonata) will help Titan capture urban consumers who are moving towards lifestyle products. We expect the watch business to continue growing at ~15% in the next three years, 4-5% of which would likely come from higher realizations.

Jewelry – continue scaling up

The Indian jewelry market (valued at Rs650bn) is highly fragmented and only 3% of the business is in the organized sector. Within this space Titan is increasingly making its presence felt as can be seen in the growth in its jewelry business (64% growth yoy in FY07). While Titan plans to continue scaling up its retail operations and is expected to have 98 Tanishq showrooms in the country by end of FY08, it also plans to improve the available product mix towards higher margin products like diamond studded jewelry. The company has also identified enough growth for organized retail at the bottom end of the jewelry business and continues to increase the number of Gold Plus showrooms to 25 by end of FY08, from 10 currently. Given Titan's strong brand equity and the minuscule share of organized jewelry formats, we expect the jewelry business to continue growing at over 25% over next three years.

New businesses – higher growth

We like Titan's measured risk appetite as it continues to invest in new growth businesses like precision engineering and eye-care. With a strong order flow from the aerospace and automobile industries in precision engineering, we expect this high margin segment to contribute significantly to revenue and net profit growth in the coming years. Furthermore, the global opportunity in Titan's target segment is worth Rs1.3trillion and India is increasingly becoming the outsourcing hub for precision engineering products. Titan has also entered the Rs25-30bn organized prescription eyewear market with the launch of its first Titan Eye+ store in April 2007. Titan plans to open ~15 stores across the country by end of FY08.

❑ Valuations and view – Maintain Outperformer

While growth will be driven by multiple avenues, margins will expand on the back of favourable product mix – Titan over Sonata, studded jewelry over pure gold jewelry and the growth in high margin precision engineering and eyewear retailing businesses. Furthermore, given the growing consumerism, Titan is an attractive lifestyle business to play on. We expect Titan to sustain ~22% revenue CAGR (over FY07 to 09) and higher profit CAGR of ~50% (FY07 to 09). Titan currently trades at valuations of 19.8x FY09E earnings, 13.0x EV/EBITDA, 1.4x EV/Sales. Maintain Outperformer with a price target of Rs1,100.

Quarterly results

	Q4FY06	FY06	Q1FY07	Q2FY07	Q3FY07	Q4FY07	FY07	FY08E	FY09E
Net Sales	**4,231**	**14,396**	**4,410**	**5,235**	**5,291**	**5,966**	**20,902**	**26,865**	**30,944**
% yoy	*33*	*33.4*	*54*	*50*	*45*	*41*	*45.2*	*28.5*	*15.2*
EBITDA	**537.4**	**1539**	**165.0**	**545.7**	**580.7**	**693.1**	**1983**	**2720**	**3373**
EBITDA	12.70	10.69	3.74	10.42	10.97	11.62	9.49	10.12	10.90
Net interest	57.9	248	48.9	43.1	46.5	65.7	204	243	154
Depreciation	51.5	224	49	65.6	69.9	71.5	256	286	309
Other Income	9.7	57	14.2	5.3	8.7	4.1	32	42	59
Provision for Contingencies	-	-	28.7	20.5	18.8	172	240	-	-
Profit before Tax	438	1,123	52.6	422	454	388	1,315	2,233	2,969
Tax	18.7	126	11.7	100.0	178.7	84.6	376	626	828
Profit After Tax	**419**	**997.2**	**40.9**	**321.8**	**275.5**	**303.4**	**926**	**1607.0**	**2140.5**
% yoy	*7*	*88.7*	*(46)*	*(10)*	*107*	*(28)*	*(7.1)*	*71.0*	*33.2*

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Explanation of Ratings:

1. Outperformer: More than 10% to Index
2. Neutral: Within 0-10% to Index
3. Underperformer: Less than 10% to Index

Disclosure of interest:

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