

Asia India

Consumer Retail/Wholesale Trade

Deutsche Bank



1 December 2011

Titan Industries Ltd

Reuters: **TITN.BO** Bloomberg: **TTAN IN** Exchange: **BSE** Ticker: **TITN**

Good franchise, great opportunity; maintaining buy

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29% increase in jewellery retail space to support volume growth

Our recent interaction with some of the leading jewellery retailers seems to suggest that jewellery volume growth during the current wedding season could be muted due to high gold prices. However, we are confident that despite a possible slowdown in gold demand, Titan will be able to show strong earnings growth because of a) aggressive new store openings (29% increase in jewellery retail space, which would support overall volume growth even if same store volume growth were to decline) and b) gold price (up 37%) is a pass through.

Can Titan maintain growth if the jewellery market starts to slow down?

We believe the company's strategy to aggressively open new Tanishq stores should help support volume growth if market growth starts to slow down. Titan plans to add 100,000sqft of jewellery retail space in FY12, an increase of 29% over FY11. 74,000 sq ft (74%) has been added in 1HFY12. Therefore, even if the gold demand in India were to slow, the aggressive store additions should help Titan elbow out smaller jewellery retailers and grab market share to maintain volume growth. While volume growth in FY11 was a result of high same store sales growth, growth in FY12/13 should result from an increase in the number of stores.

Operating leverage to continue to support jewellery margins

The shift to high margin studded jewellery from plain gold jewellery might not be significant in FY12, but as 80% of the jewellery stores are franchise/semi-franchise stores, the operating leverage should continue to support the jewellery margin. The jewellery margin expansion over the last two quarters – despite a marginal decline in the proportion of studded jewellery – is a testament to our thesis.

34% earnings CAGR (FY11-13) driver of target price of INR 265; risks

Our DCF-derived target price of INR265 is based on 13.75% CoE, 34% earnings CAGR over FY11-13E. At our target price, the exit multiple is 30x FY13. At the current stock price of INR186, the stock trades at 21x FY13 earnings. Jewellery volume decline due to volatility in gold price is the biggest downside risk to our earnings (see Risks section, page 8).

Forecasts and ratios

Year End Mar 31	2010A	2011A	2012E	2013E	2014E
Sales (INRm)	46,744.2	65,209.0	88,865.5	106,139.8	125,938.7
EBITDA (INRm)	3,949.6	5,857.6	8,221.1	10,432.9	13,390.3
Reported NPAT (INRm)	2,532.4	4,337.9	6,154.1	7,788.0	9,874.9
DB EPS FD(INR)	2.85	4.89	6.93	8.77	11.12
OLD DB EPS FD(INR)	2.85	4.89	7.14	8.98	11.30
% Change	0.0%	0.0%	-3.0%	-2.4%	-1.6%
DB EPS growth (%)	49.0	71.3	41.9	26.5	26.8
PER (x)	22.9	30.7	26.8	21.2	16.7

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Forecast Change

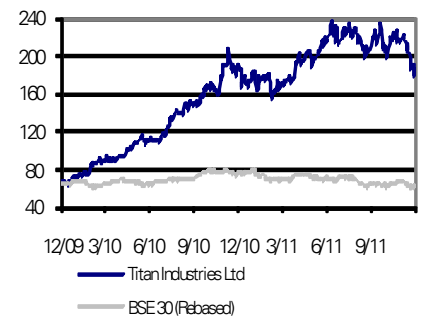
Buy

Price at 1 Dec 2011 (INR)	186.10
Price target - 12mth (INR)	265.00
52-week range (INR)	235.75 - 154.30
BSE 30	16,483

Key changes

Price target	275.00 to 265.00	↓	-3.6%
Sales (FYE)	87,403 to 88,866	↑	1.7%
Op prof margin (FYE)	9.3 to 8.8	↓	-5.7%
Net profit (FYE)	6,342.5 to 6,154.1	↓	-3.0%

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-13.4	-9.5	-1.8
BSE 30	-5.7	-1.2	-17.0

Stock data

Market cap (INRm)	165,217
Market cap (USDm)	3,210
Shares outstanding (m)	887.8
Major shareholders	TIDCO (28%)
Free float (%)	49
Avg daily value traded (USDm)	17.802

Key indicators (FY1)

ROE (%)	51.1
Net debt/equity (%)	-82.2
Book value/share (INR)	15.59
Price/book (x)	11.9
Net interest cover (x)	195.3
Operating profit margin (%)	8.8

Deutsche Bank AG/Hong Kong

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Model updated:01 December 2011

Running the numbers**Asia****India****Retail/Wholesale Trade****Titan Industries Ltd**

Reuters: TITN.BO

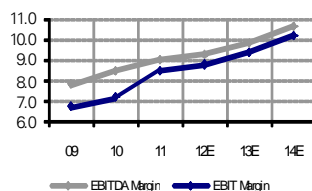
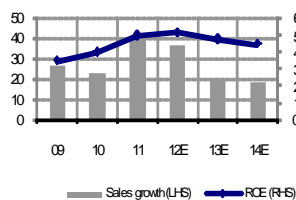
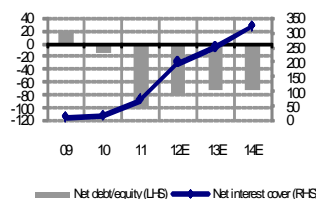
Bloomberg: TTAN IN

Buy

Price (1 Dec 11)	INR 186.10
Target price	INR 265.00
52-week Range	INR 154.30 - 235.75
Market Cap (m)	INRm 165,217 USDm 3,210

Company Profile

Titan Industries Limited is an India-based manufacturer of watches and jewellery employing 3,800 people. It also manufactures eye wear, precision engineering, machine building and clocks. The Company manufactures over 8 million watches per annum and has a customer base of over 80 million. Titan and Tanishq are among the most admired brands in their categories.

Price Performance**Margin Trends****Growth & Profitability****Solvency**

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Fiscal year end 31-Mar

	2009	2010	2011	2012E	2013E	2014E
Financial Summary						
DB EPS (INR)	1.91	2.85	4.89	6.93	8.77	11.12
Reported EPS (INR)	1.91	2.85	4.89	6.93	8.77	11.12
DPS (INR)	0.40	0.75	1.25	2.50	2.50	3.50
BVPS (INR)	6.2	8.2	11.5	15.6	21.5	28.6

Weighted average shares (m)	888	888	888	888	888	888
Average market cap (INRm)	47,956	58,018	133,388	165,217	165,217	165,217
Enterprise value (INRm)	49,087	56,803	123,024	153,745	151,070	146,595

Valuation Metrics

P/E (DB) (x)	28.2	22.9	30.7	26.8	21.2	16.7
P/E (Reported) (x)	28.2	22.9	30.7	26.8	21.2	16.7
P/BV (x)	6.28	11.28	16.50	11.93	8.66	6.52
FCF Yield (%)	1.7	5.7	7.9	2.2	3.2	4.9
Dividend Yield (%)	0.7	1.1	0.8	1.3	1.3	1.9
EV/Sales (x)	1.3	1.2	1.9	1.7	1.4	1.2
EV/EBITDA (x)	16.5	14.4	21.0	18.7	14.5	10.9
EV/EBIT (x)	19.3	17.0	22.3	19.7	15.2	11.4

Income Statement (INRm)

Sales revenue	38,034	46,744	65,209	88,866	106,140	125,939
Gross profit	10,632	11,857	17,158	22,440	27,208	32,067
EBITDA	2,966	3,950	5,858	8,221	10,433	13,390
Depreciation	418	601	345	411	486	561
Amortisation	0	0	0	0	0	0
EBIT	2,548	3,349	5,513	7,810	9,947	12,829
Net interest income/(expense)	-294	-254	-82	-40	-40	-40
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	53	119	561	730	850	850
Profit before tax	2,307	3,213	5,991	8,500	10,757	13,639
Income tax expense	607	681	1,654	2,346	2,969	3,764
Minorities	0	0	0	0	0	0
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	1,700	2,532	4,338	6,154	7,788	9,875
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	1,700	2,532	4,338	6,154	7,788	9,875

Cash Flow (INRm)

Cash flow from operations	1,599	3,691	11,128	5,172	6,739	9,564
Net Capex	-767	-410	-620	-1,500	-1,500	-1,500
Free cash flow	832	3,281	10,508	3,672	5,239	8,064
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-408	-776	-1,282	-2,563	-2,563	-3,589
Net inc/(dec) in borrowings	-825	-1,026	-51	-657	0	1
Other investing/financing cash flows	430	-159	614	0	0	0
Net cash flow	29	1,320	9,790	451	2,675	4,476
Change in working capital	-519	558	6,445	-1,393	-1,535	-872

Balance Sheet (INRm)

Cash and other liquid assets	547	1,867	10,949	11,400	14,075	18,552
Tangible fixed assets	2,940	2,749	3,024	4,113	5,127	6,066
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	77	76	91	91	91	91
Other assets	14,230	16,170	23,275	31,752	37,925	44,999
Total assets	17,794	20,863	37,340	47,357	57,218	69,708
Interest bearing debt	1,754	728	677	20	20	21
Other liabilities	10,528	12,891	26,409	33,493	38,130	44,332
Total liabilities	12,282	13,619	27,086	33,513	38,150	44,353
Shareholders' equity	5,512	7,244	10,254	13,844	19,069	25,355
Minorities	0	0	0	0	0	0
Total shareholders' equity	5,512	7,244	10,254	13,844	19,069	25,355
Net debt	1,207	-1,139	-10,272	-11,380	-14,055	-18,531

Key Company Metrics

Sales growth (%)	27.0	22.9	39.5	36.3	19.4	18.7
DB EPS growth (%)	7.3	49.0	71.3	41.9	26.5	26.8
EBITDA Margin (%)	7.8	8.4	9.0	9.3	9.8	10.6
EBIT Margin (%)	6.7	7.2	8.5	8.8	9.4	10.2
Payout ratio (%)	20.8	26.3	25.6	36.1	28.5	31.5
ROE (%)	34.4	39.7	49.6	51.1	47.3	44.5
Capex/sales (%)	2.0	0.9	1.0	1.7	1.4	1.2
Capex/depreciation (x)	1.8	0.7	1.8	3.6	3.1	2.7
Net debt/equity (%)	21.9	-15.7	-100.2	-82.2	-73.7	-73.1
Net interest cover (x)	8.7	13.2	67.1	195.3	248.7	320.7

Source: Company data, Deutsche Bank estimates

Good franchise, great opportunity

Our recent interaction with some of the leading jewellery retailers seems to suggest that jewellery volume growth could be slowing down during the current wedding season due to high gold prices. Although the wedding season just started in November and it is too early to predict a trend, the initial indications suggest that volume growth could be muted for the second half of the year. However, we are confident that despite a possible slowdown in gold demand, Titan will be able to grow earnings because of a) aggressive new store openings (29% increase in jewellery retail space will support overall volume growth even if same store volume growth were to decline) and b) gold price (up 37% yoy) is a pass through.

How can Titan maintain growth if the jewellery market in India starts to slow down?

In the wake of high gold prices and moderate volume growth, we believe the company's strategy to aggressively open new Tanishq stores will help support volume growth. Titan plans to add 100,000 sq ft in FY12, an increase of 29% over FY11. 74,000 sq ft (74%) has already been added in 1HFY12, and the company is planning to add another 26,000 sq ft by the end of the year. Therefore, even if the gold demand in India were to slow down, the aggressive store addition should help Titan elbow out smaller jewellery retailers and grab market share. The current market share of Titan in the gold market in India is about 5%.

This was illustrated in 2QFY12 as well, when even though the same store volume growth was -3%, the overall volume growth was +3% (Titan reported a 44% growth in jewellery revenues in Q2). At the same time, the jewellery market volume growth in India was -26%, and only 3% in value terms (according to the World Gold Council)

Therefore, while volume growth in FY11 was a result of high same store sales growth, growth in FY12/13 should result from an increase in the number of stores. Moreover, aggressive floor space addition does not mean high capex, as 80% of Tanishq stores are franchise/semi-franchise stores. The franchise model gives Titan the ability to ensure faster rollouts while maintaining an asset-light balance sheet.

Figure 1: 29% increase in jewellery retail space to support volume growth

	FY10	FY11	FY12e	1HFY12
Jewellery retail space (sqft)	300,000	342,000	442,000	414,000
Growth%	Flat	14.0%	29.2%	29.0%
Total retail space (sqft)	685,000	810,000	975,000	925,000
Growth%	13.4%	18.2%	20.4%	14.2%

Source: Company data, Deutsche Bank estimates

Key assumptions and forecasts

Jewellery -

- **FY12** – We have assumed 41% jewellery revenue growth for FY12, driven by a 26% increase in gold price and 12% volume growth. We have factored in an average gold price of INR2594/gm for FY12.
- **2HFY12** – Our FY12 estimates imply 32% growth in jewellery revenues for 2HFY12. We factor in a 28% gold price increase and 4% overall volume growth. The current gold price is c40% higher than the average price for 2HFY12.
- **FY13** – We have assumed 20% jewellery revenue growth for FY13, driven by 10% volume growth and a 10% increase in gold price. We have factored in an average gold price of INR2854/gm for FY13, which is close to the current gold price of 2900/gm.

Watches -

- **FY12** – We have assumed 15% volume growth and 4% realization growth in watches for FY12. We have factored in a 6% price increase in watches, which management announced in October.
- **2HFY12** – Our FY12 estimates imply 14% growth in watch revenues for 2HFY12. We factor in 6% price increase and 8% volume growth.
- **FY13** – We have assumed steady watch business, with 13% volume growth and a 3% increase in realization.

Figure 2: Key assumptions on jewellery and watch business

	FY11	FY12e	FY13e	Remarks
Jewellery volume growth	14%	12%	10%	Jewellery realization now factors in average gold prices of INR2,594/gm for FY12; INR2,854/gm for FY13
Gold price increase	24%	26%	10%	
Watch volume growth	23%	15%	13%	Realization growth assumption factors in a 6% price hike taken in October '11
Watch realization growth	1%	4%	3%	

Source: Deutsche Bank

Recent stock price correction an opportunity

Titan's stock price has seen a significant correction over concerns on slowing volume growth, possibly high advertising spends to maintain volume growth and no margin expansion due to a slowing shift to studded jewellery.

Volume growth

While we believe initial indications do suggest a slowdown in volume growth, Titan should be able to show volume growth well above the market due to a 29% increase in jewellery retail space. Therefore, even if same store volume growth were to decline, the overall volume growth would still remain positive.

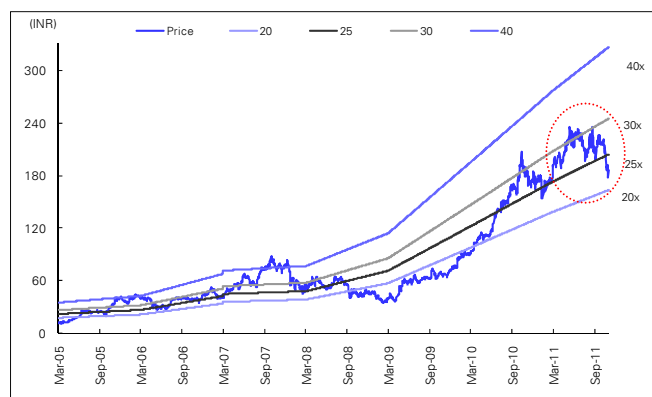
High advertising spend to support volume growth

We have factored in 33% growth in advertising spends for FY12 and 28% growth in FY13. However, due to the high revenue growth of 36% and 20% in FY12/FY13E, respectively, the ad-sales ratio should not change significantly. Our assumptions imply 4.5% and 4.9% ad-sales ratio for FY12/FY13, respectively, after 4.7% in FY11.

Margin expansion to freeze

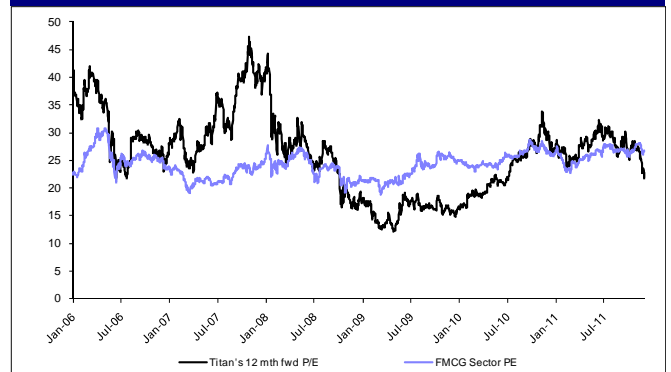
The shift to studded jewellery from plain gold jewellery might not be significant in FY12, but as 80% of the jewellery stores are franchise/semi-franchise, we believe the operating leverage will continue to support jewellery EBIT margin. This is illustrated by the jewellery margin expansion over the last two quarters: despite the proportion of studded jewellery marginally declining since FY11, the jewellery margins expanded.

Figure 3: Titan's one-year forward PE band



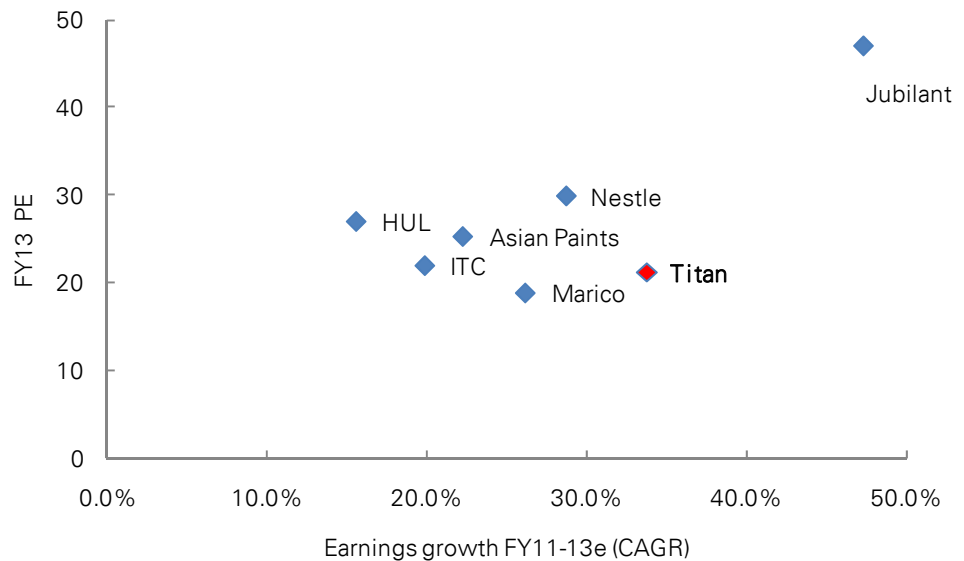
Source: Deutsche Bank

Figure 4: Titans one-year forward PE vs. one-year forward FMCG sector PE



Source: Deutsche Bank

Figure 5: PE vs. earnings growth – Titan vs. other FMCG players



Source: Deutsche Bank

Valuation

34% earnings CAGR FY11-13 drives target price of INR265

A 34% CAGR in FY11-FY13, earnings is the driver of our DCF-derived target price of INR265. Our target price is based on cost of equity of 13.75% and 4% terminal growth.

The key assumptions for our two-stage FCFE methodology are:

- a) Risk-free rate of 6.7%, market risk premium of 8.1% (we apply a standard estimated risk-free rate and market risk premium to all the Indian companies we cover) and beta of 0.87 (Bloomberg Finance LP).
- b) We have taken a growth in the stable phase of 4%. We have taken this growth rate with the assumption that the long-term growth would be driven by the penetration of organized retail and consequently, demand for branded watches jewellery and eyewear.

Our target price for Titan works out to INR265. At our target price, the exit PE works out to 30x FY13. We are 3% ahead of consensus on FY12 earnings and 6% ahead of consensus on FY13 earnings.

Deutsche Bank estimates vs. consensus

We are 3% and 5% higher than consensus on FY12/13 earnings, respectively.

Figure 6: Deutsche Bank estimates vs. consensus

	FY12			FY13		
	DBe	Consensus		DBe	Consensus	
Sales	88,866	85,985	3.4%	106,140	103,030	3.0%
EBITDA	8,221	8,104	1.4%	10,433	10,014	4.2%
PAT	6,154	5,955	3.3%	7,788	7,385	5.5%

Source: Deutsche Bank, Bloomberg Finance LP

Figure 7: DCF valuation for Titan

Cost of Equity =	13.75%
Proportion of Debt: Capital Spending (DR)=	0.10%
Proportion of Debt: Working Capital (DR)=	0.10%
Current Earnings per share=	8.8
(Capital Spending - Depreciation)*(1-DR)	1.1
Change in Working Capital * (1-DR)	- 1.7
Current FCFE	9.4

Growth Rate in Earnings per share

	<i>Growth Rate</i>	<i>Weight</i>
Historical Growth =	37.51%	0.00%
Outside Estimates =	45.23%	60.00%
Fundamental Growth =	29.20%	40.00%
<i>Weighted Average</i>	38.82%	

Growth Rate in capital spending, depreciation and working capital

	<i>High Growth</i>	<i>Stable Growth</i>
Growth rate in capital spending =	38.82%	4.00%
Growth rate in depreciation =	38.82%	4.00%
Growth rate in revenues =	38.82%	4.00%

Working Capital as percent of revenues = 13% (in percent)

The FCFE for the high growth phase are shown below (upto 6 years)

INR/share	1.00	2.00	3.00	4.00	5.00
Earnings	12.2	16.9	23.5	32.6	45.2
- (CapEx-Depreciation)*(1-DR)	1.6	2.2	3.1	4.2	5.9
-Chg. Working Capital*(1-DR)	6.1	8.4	11.7	16.2	22.5
Free Cashflow to Equity	4.5	6.3	8.7	12.1	16.8
Present Value	4.0	4.9	5.9	7.2	8.8

Growth Rate in Stable Phase =	4.00%
FCFE in Stable Phase =	43.81
Cost of Equity in Stable Phase =	13.75%
Price at the end of growth phase (INR/share) =	450

Present Value of FCFE in high growth phase (INR/share)=	31
Present Value of Terminal Price (INR/share) =	236
Value of the stock (INR/share)=	267

Estimating the value of growth (INR/share)

Value of assets in place =	68
Value of stable growth =	32
Value of extraordinary growth =	167
Value of the stock =	267

Source: Deutsche Bank

Risks and concerns

Jewellery volume decline due to volatility in gold price

We see a decline in jewellery volumes due to the high volatility in gold price as the biggest downside risk. We have seen that whenever there is volatility in gold price, the consumers tend to temporarily stay away from the market. Also, while we expect Titan to fully pass through gold price increases, a too-high gold price increase may cause a volume collapse, putting our earnings estimates at risk.

International presence

Titan opened 12 stores in Europe in the 1990s and had to write off its international foray. Management clarified that they have no plans for any major acquisitions – India is the management's focus market. Moreover, they also confirmed that any such acquisition would have to be vetted by the two promoters, TIDCO and Tata.

Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Titan Industries Ltd	TITN.BO	186.10 (INR) 1 Dec 11	NA

*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

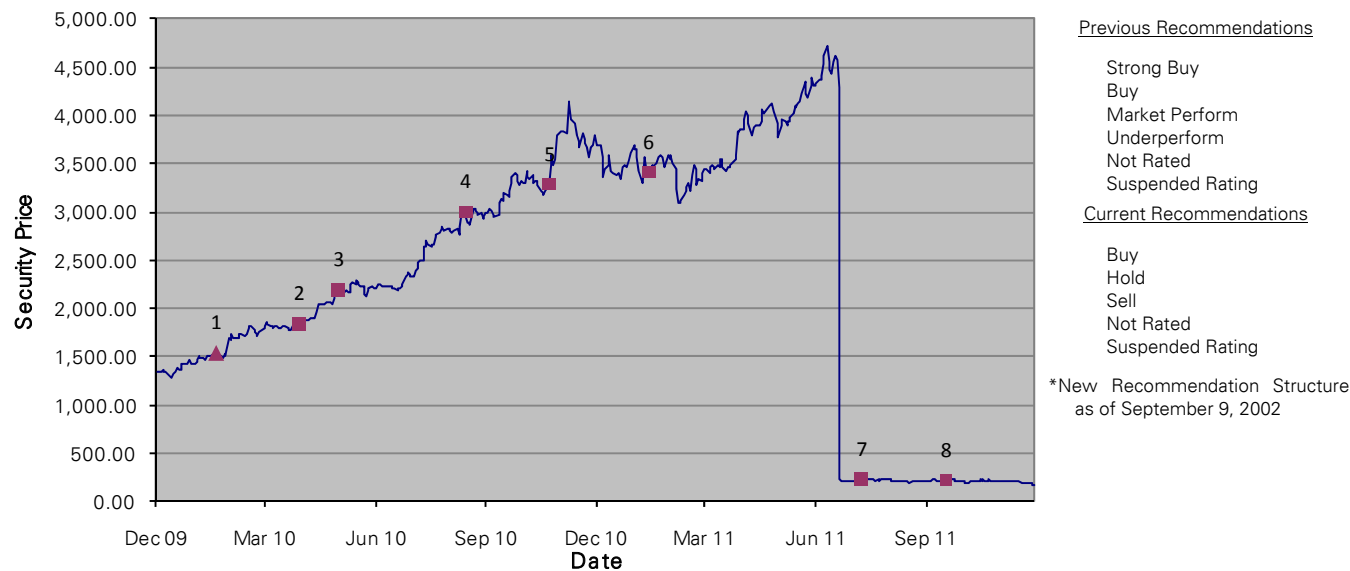
For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/Disclosure.eqsr?ricCode=TITN.BO>.

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Gaurav Bhatia

Historical recommendations and target price: Titan Industries Ltd (TITN.BO)

(as of 12/1/2011)



1.	21/1/2010:	Upgrade to Buy, Target Price Change INR1,705.00	5.	25/10/2010:	Buy, Target Price Change INR3,825.00
2.	31/3/2010:	Buy, Target Price Change INR2,150.00	6.	15/1/2011:	Buy, Target Price Change INR4,200.00
3.	3/5/2010:	Buy, Target Price Change INR2,500.00	7.	11/7/2011:	Buy, Target Price Change INR250.00
4.	16/8/2010:	Buy, Target Price Change INR3,500.00	8.	19/9/2011:	Buy, Target Price Change INR275.00

Equity rating key

Equity rating dispersion and banking relationships

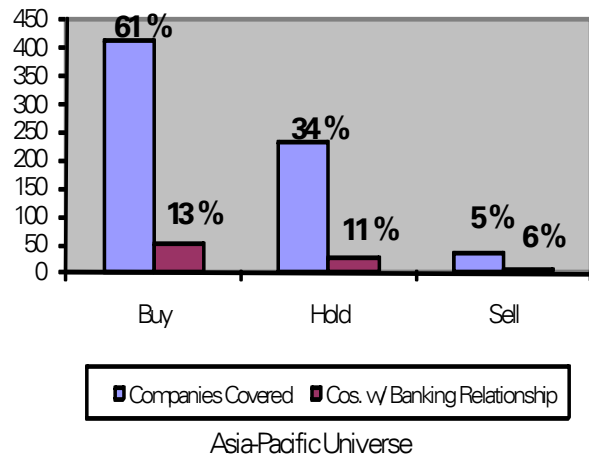
Buy: Based on a current 12- month view of total shareholder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total shareholder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.
2. Ratings definitions prior to 27 January, 2007 were:
 - Buy: Expected total return (including dividends) of 10% or more over a 12-month period
 - Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period
 - Sell: Expected total return (including dividends) of -10% or worse over a 12-month period



Regulatory Disclosures

1. Important Additional Conflict Disclosures

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