Titan – ADD

20 September 2011

Initiating coverage

IIFL Institutional Equities

Gold standard

Titan is the best play on growing discretionary consumption in India. Titan has mature brands in potentially large categories like branded jewellery. It has a high-quality leadership team and its return ratios are comparable with best-in-class Indian FMCG players. These factors, coupled with continued shift in consumer preference to branded products, should help Titan deliver earnings CAGR of 27% over FY11-14. However, at 27x FY13 earnings, valuations do not factor in near-term concerns of sharp fall in gold prices or slowdown in discretionary spending. We initiate with ADD and target price of Rs232.

Jewellery to sustain strong growth, aided by expansion: We expect Titan's jewellery division to sustain 20% revenue growth over FY12-14. This would be supported by a continued shift in consumer preference to branded jewellery and 25% addition in retail space in the most profitable *Tanishq* large-format stores. FY12 growth would be robust due to significantly higher YoY gold prices, currently c40% higher than the FY11 average.

Watches susceptible to slowdown, eyewear promising: Mixed trends can been seen in Titan's watch business: the economy segment is slowing down whereas the mid-priced and premium segments are holding strong, helped by expansion in *Helios*, the premium multi-brand format. We believe the premium watches segment too would suffer if there is further weakening in consumer sentiment. The prescription eyewear business is promising with Titan establishing immense lead over other branded players.

Strengthening free cash flow, ROIC comparable with best in class FMCG companies: Titan's free cash flow increased sharply from Rs3.1bn in FY10 to Rs10.4bn in FY11, led by the jewellery business, which has structurally moved to negative invested capital. Titan's ROIC increased from 51% to 179% over FY10-11. We expect the business to generate free cash flow of Rs22bn over FY12-14, which would be utilised for faster expansion and possibly a higher dividend payout.

Company update

CMP	**Rs221**
12-mth TP (Rs)	***232 (5%)***
Market cap (US$ m)	**4,086**
Bloomberg	**TTAN IN**
Sector	**Consumer goods**

Shareholding pattern (%)

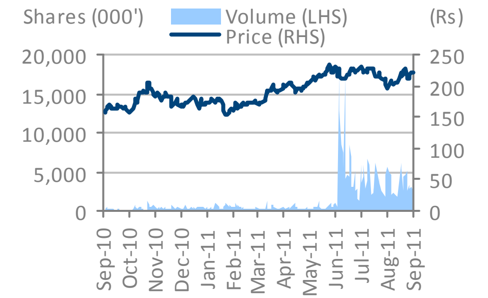
Promoters	53.3
FIIs	12.5
DIIs	6.2
Public	28.0

52Wk High/Low (Rs)	238/140
Shares o/s (m)	888
Daily volume (US$ m)	31
Dividend yield FY12ii (%)	0,8
Free float (%)	47.0

Price performance (%)

	1M	3M	1Y
Titan Inds	12.5	-3.4	40.0
Rel. to Sensex	**8.8**	**1.0**	**56.0**
Shopper Stop	3.2	-8.1	22.2
Pantaloon Retail	-10.8	-12.3	-51.0

Stock performance



Financial summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenues (Rs m)	46,744	65,209	88,124	108,199	128,999
EBITDA Margins (%)	8.4	9.0	8.8	8.6	8.8
Pre-Exceptional PAT (Rs m)	2,532	4,336	5,822	7,096	8,736
Reported PAT (Rs m)	2,503	4,304	5,822	7,096	8,736
Adj. EPS (Rs)	2.9	4.9	6.6	8.0	9.8
Growth (%)	49.2	71.2	34.3	21.9	23.1
IIFL vs consensus (%)			-1.9	-3.5	9.5
PER (x)	**77.5**	**45.2**	**33.7**	**27.7**	**22.5**
ROE (%)	34.6	42.0	40.6	36.8	34.4
EV/EBITDA (x)	49.4	31.7	23.4	19.0	14.9
Price/Book (x)	27.1	19.1	13.7	10.2	7.7

Source: Company, IIFL Research. Priced as on 19 September 2011

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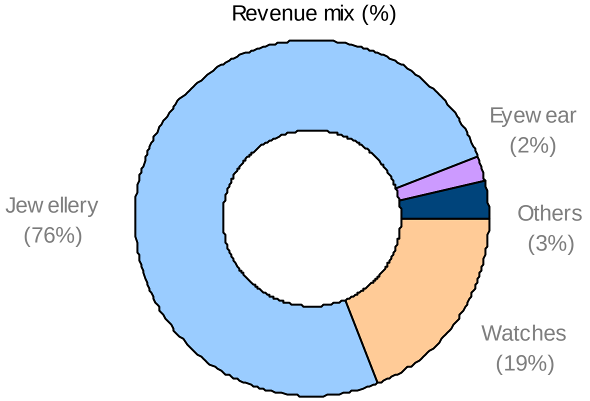
Company snapshot

Titan Industries is India's leading player in branded jewellery, watches and precision eyewear. The company was formed in 1984 as a joint venture between the Tata Group and Tamil Nadu Industrial Development Corporation. The company first entered the watches market and emerged as a dominant market leader with its brands *Titan* and *Sonata*. With its branded retail chain *Tanishq*, Titan successfully entered the large but fragmented jewellery business in 1995. *Tanishq* now contributes to a majority of Titan's profit. Titan is also a leading player in branded precision eyewear and operates in youth accessories with the *Fast Track* brand.

Business mix

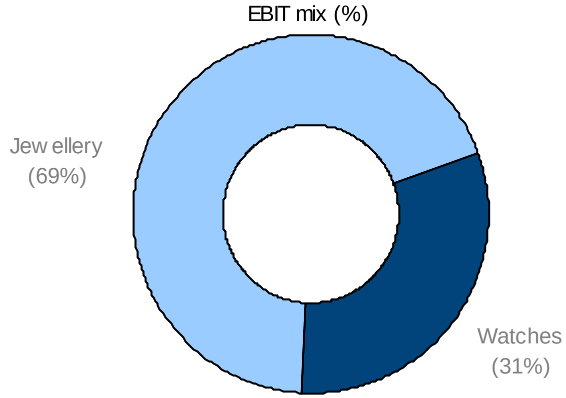
Titan has three main businesses – jewellery, watches and eyewear. Eyewear is yet to break even as a business. Jewellery is Titan's largest component in revenue and EBIT contribution.

Figure 1: The jewellery division dominates Titan's revenue



Source: Company, IIFL Research

Figure 2: Titan's EBIT is also dominated by the jewellery division



Source: Company, IIFL Research

Management team

Figure 3: Titan has a very high-quality leadership team

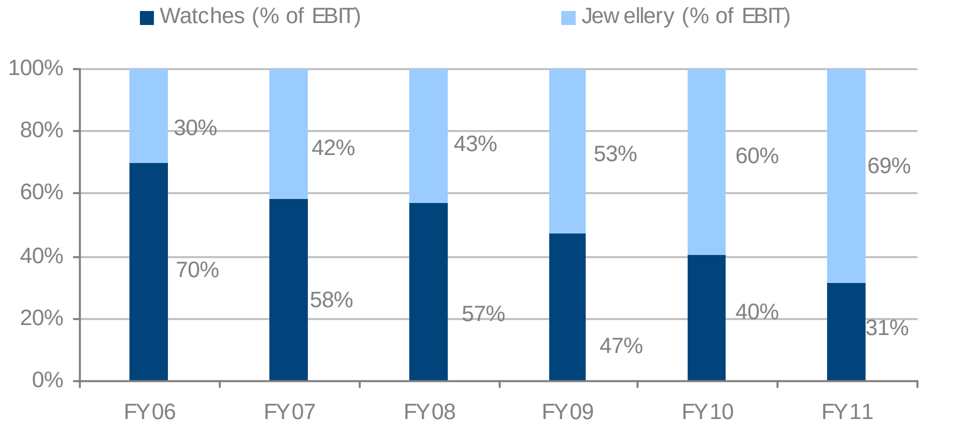
Senior management	A
Bhaskar Bhat Managing Director	• Has been Managing Director since 2002, Joined Titan in 1983 • PGDM from IIM Ahmedabad, B.Tech from IIT Madras
CK Venkataraman COO Jewellery	• Has headed the Jewellery division since 2005; joined Titan in 1990 • PGDM from IIM Ahmedabad
Harish Bhat COO Time Products	• Earlier head of the Jewellery division, now COO Time Products PGDM from IIM Ahmedabad (gold medalist), BITS Pilani • A member of Tata Administrative Services (TAS)
S Ravi Kant COO Eyewear	• Joined Titan in 1988 • MBA from FMS, Delhi
Subbu Subramaniam CFO	• CA and ICWA with more than 25 years experience in management • Recently joined Titan, was CFO for Essar's Telecom vertical. He was also worked in senior positions in ITC and BPL mobile.

Source: Company, IIFL Research

Jewellery: The mainstay of Titan on a strong wicket

Titan's Jewellery division has emerged as the mainstay of its business with EBIT contribution of c70% in FY11, up from 30% in FY06. The contribution of this division is increasing continuously, making it the lynchpin of the investment thesis on Titan.

Figure 4: Jewellery has now become the mainstay of Titan's business

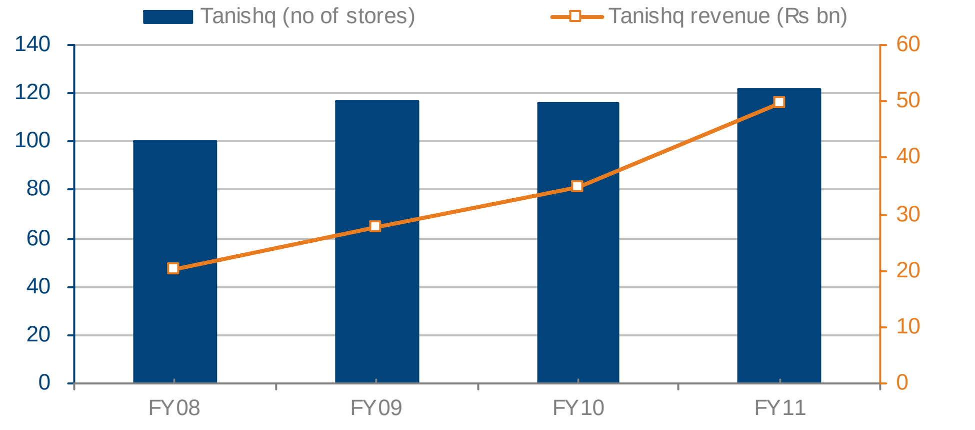


Source: Company, IIFL Research

We expect the business to deliver revenue and EBIT CAGR of 27% over FY11-14. Titan is the largest organised jewellery retailer nationally, far ahead of its nearest rival. Further, given the consumer trust associated with the Tata brand, we expect Titan to ride on the continued consumer shift from unbranded to branded jewellery. Other key drivers for this growth would be significant space addition of c25% in FY12 after a gap on two years and improving operating metrics due to increasing contribution from large-format stores.

Jewellery division adding significant retail space after two years
Revenue of Titan's jewellery business increased 80% in the past two years without any meaningful addition to retail space, which stood at 0.385m sqft as at end-FY11. Thus, the growth was almost entirely due to same-store sales growth, driven by volumes and gold prices (48% increase in average gold price over two years).

Figure 5: *Tanishq's* revenue has grown strongly despite no major store addition



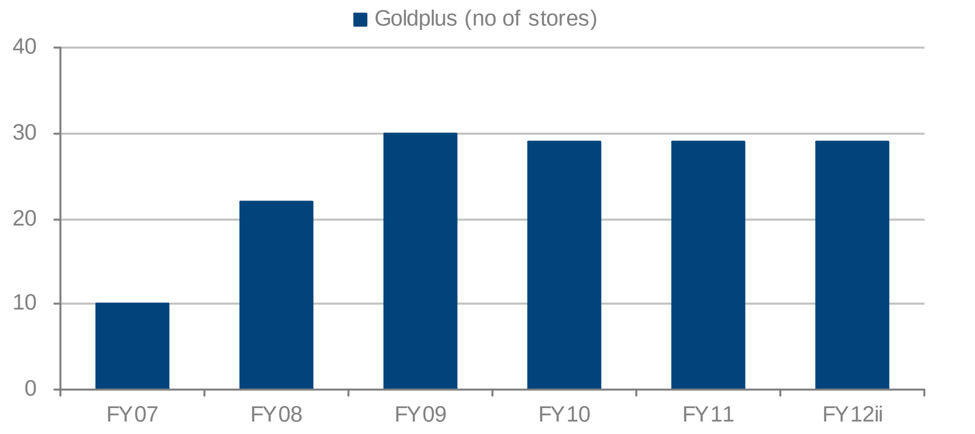
Source: Company, IIFL Research

The company plans to add 0.1m sqft of space in FY12, which entails more than 25% space addition over the FY11 retail space. This would boost revenue growth in FY12 over and above strong same store sales growth, supported by the YoY increase in gold prices in FY12.

Space addition concentrated on the most profitable store format
The space addition is focused on large formats (>10,000 sqft) of *Tanishq*. In the past two years, these stores have delivered higher sales per sqft and profitability and contribute significantly to brand equity compared with the smaller-format stores which form a majority of *Tanishq's* retail space at present. *Tanishq* started opening large-format stores only a couple of years ago and has since seen a number of large-format stores delivering consistently higher performance compared with the previous average store size of 2,500-4,000 sqft.

The company is also clear that it would not expand the *Gold Plus* retail format, which is yet to achieve the threshold of profitability expected by the management. The company would continue experimenting with the business model to achieve the intended profitability level.

Figure 6: *Goldplus*, which is lower in profitability, is unlikely to see any expansion

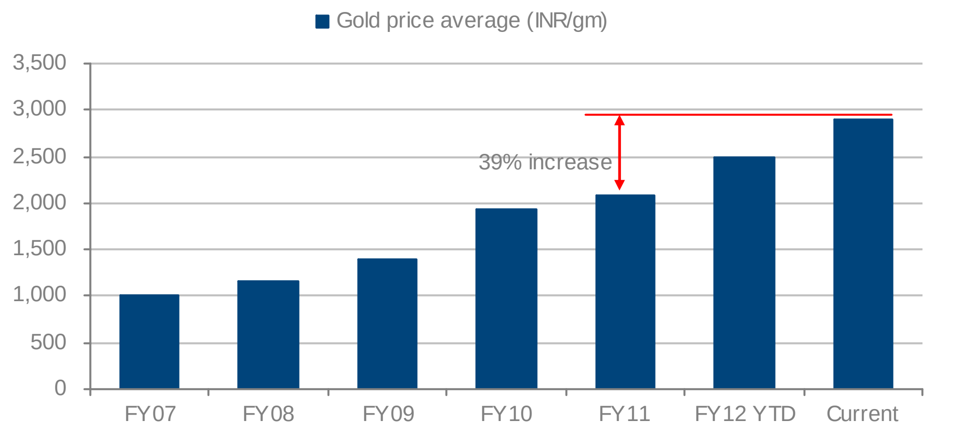


Source: Company, IIFL Research

40% YoY higher gold price will ensure high growth in FY12

Growth in same-store sales would be boosted by higher gold prices in FY12, as current gold price is c40% higher than the average of FY11. Thus, even a moderate correction in gold price would ensure significantly higher YoY prices in FY12.

Figure 7: Current gold price is c40% higher than the FY11 average price

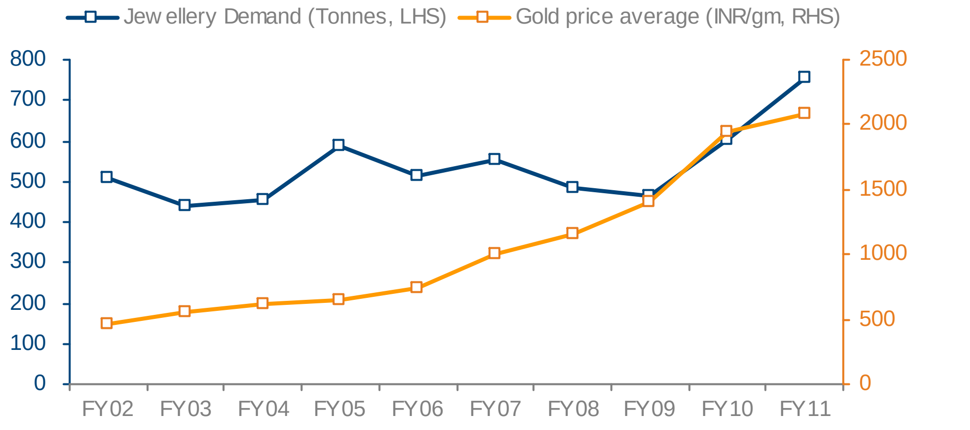


Source: Company, IIFL Research

No clear correlation between gold prices and jewellery demand

We analysed data over the past ten years and we see no clear correlation between gold price and jewellery demand in India. Even if we look over the past four years, trends appear divergent. FY08 and FY09 saw decline in jewellery demand in India when gold prices increased 40%. However, we jewellery demand started rising in FY10 and FY11 despite 48% rise in gold prices over these two years.

Figure 8: Jewellery demand in India has not had a clear correlation with gold price

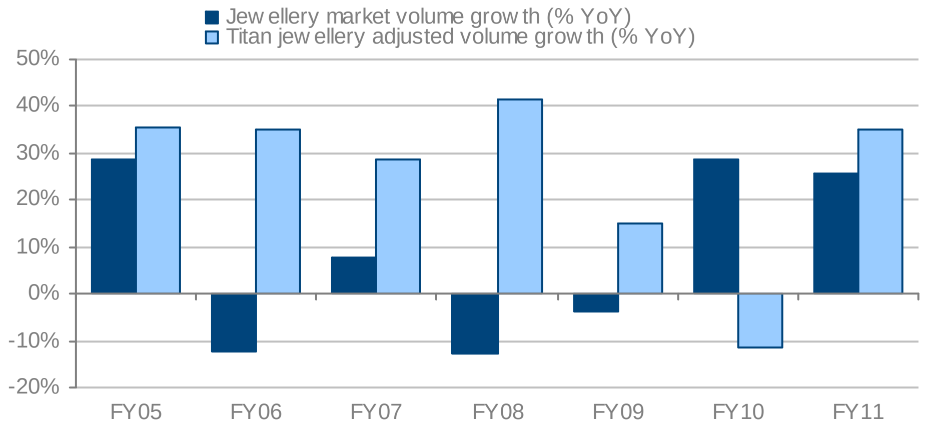


Source: Company, IIFL Research

Tanishq likely to grow ahead of the market growth

The Indian jewellery market is estimated at cUS$25bn and *Tanishq's* jewellery revenue is just more than US$1bn. Thus *Tanishq* forms less than 5% of the total jewellery market in India despite being a mature consumer brand. This gives it significant head room to grow. The branded jewellery market itself forms less than 10% of the total jewellery market. As consumers shift to branded jewellery for better designs and quality, we expect this segment to outgrow the overall market consistently. *Tanishq*, the market leader with the widest presence, is clearly the biggest beneficiary of this trend. The consumer trust associated with the Tata brand is also an advantage in a category like jewellery. An analysis of Titan's implied volume growth for jewellery since FY05 shows that the company has grown significantly ahead of the market growth except in FY10.

Figure 9: *Tanishq* has grown ahead of overall jewellery demand except in FY10



Source: Company, IIFL Research

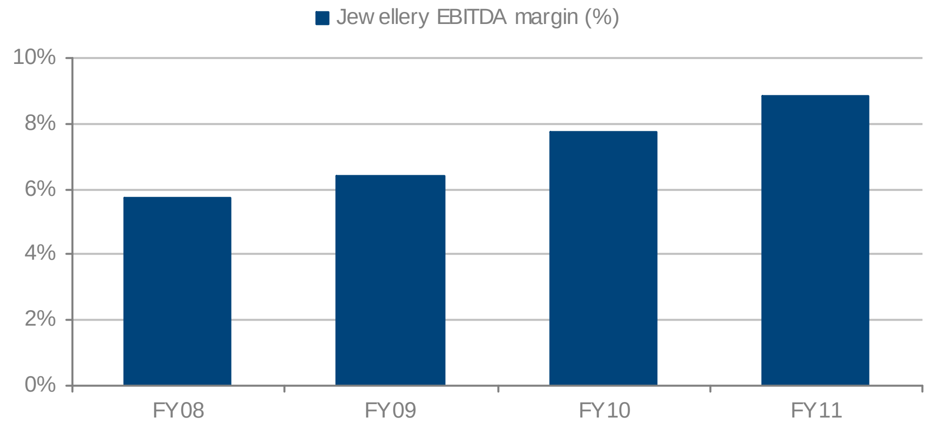
We expect margins could see marginal decline in 2HFY12 and expand thereafter

Titan's jewellery business has seen a strong expansion in EBIT margin over the past four years. This has been on the back of growth in strong same-store sales, minimal store start-up costs and an increasing proportion of revenue of large-format stores in the revenue mix. Large-format stores offer higher profitability and are owned by Titan. We expect EBITDA margins to decline marginally in 2H FY12 and expand thereafter. Key margin drivers:

- **Operating leverage will continue to help margins:** Operating leverage from high growth in same store sales would continue to help expand margins. FY12 same-store sales growth is likely to be strong given that gold prices are 40% higher now YoY vs. the FY11 average.
- **FY12 will see increased costs from a spurt in new space addition:** As the company is adding c25% retail space in FY12, initial costs of rollout and time to break even for new store would likely be a negative for FY12 margins.
- **Focus on larger-format stores likely to help margins:** Bulk of the expansion in retail space in *Tanishq* is now happening in large-format stores. These are 10,000 sqft stores compared with 2,500-4,000 sqft older *Tanishq* outlets. The management has seen larger-format stores having better margins and aiding *Tanishq's* brand equity. As the mix of space shifts towards larger sizes, we expect margins to improve over the next 2-3 years.
- **Studded jewellery likely to maintain higher volume growth than pure gold:** Titan enjoys 2.5x higher margins in studded jewellery compared with pure gold jewellery. Studded jewellery formed 28% of jewellery revenue in FY11. In FY12, revenue share of studded jewellery is likely to come off due to the spike in gold prices. However, structurally, over the medium term we expect studded jewellery to see higher volume growth than pure gold jewellery, which would help margins. The growth would be led by preference among younger consumers for studded jewellery.
- **Titan is hedged for over 95% of gold purchases:** Titan takes gold on lease for a six-month period and locks in gold price every day for the amount of gold sold. This covers more than 95% of the gold purchases, insulating margins from fluctuations in gold prices.
- **Diamond inventory loss impact if any unlikely to be material:** Titan has no hedges for diamond prices, which have seen substantial volatility recently after remaining stable for many years. Rough diamond prices rallied c90% during December 2010 to May 2011 and corrected 10-15% in the past month. Studded jewellery (which includes diamonds) forms c28% of Titan's jewellery sales, implying that diamond share of inventory would be 15-20%. Thus, there could be an impact on diamond price movement on inventory gains or losses, which should not be large for the full year, although the impact may be larger at the sequential level.

We expect margins in Titan's jewellery business to marginally decline in 2HFY12 as operating leverage and the initial space rollout costs play out against each other. We expect EBITDA margins to increase marginally over FY13-14 helped by higher mix of larger stores as the new stores ramp up.

Figure 10: Jewellery EBIT margins expanded due to high same-store sales growth, no space addition costs and increasing share of large formats



Source: Company, IIFL Research

Key risks to our growth hypothesis

- **A sharp fall in gold prices:** While there is no data to conclusively establish the correlation between gold prices and gold demand, Titan has definitely gained from operating leverage on overheads as gold price went up more than 80% in the past two years. Titan charges on an average c20% of the price as making charge, which has helped in the past three years of sharp gold price increase. Meanwhile, overhead costs like employee costs, marketing, rent and distribution moved up normally. If gold prices come off sharply, there could be an adverse impact on jewellery margins.
- **Increase in excise duty on branded jewellery:** The government introduced 1% excise duty on branded jewellery. If this rate is increased it would create a major competitive disadvantage for branded jewellery players like *Tanishq*.
- **Government reduces the threshold for PAN number:** The government recently introduced the requirement of PAN number for billing of more than Rs500,000 of jewellery. This has not had an impact as the proportion of sale of such high-value jewellery is less than 10% in *Tanishq*. However, if the government lowers this threshold, it could have an adverse impact.
- **Increase in gold lease cost:** Titan leases gold from MMTC at an annualised lease cost of c3.5%. This lease rate moved up sharply in 2008 during the global financial crisis as it depends on LIBOR.
- **Sharp slowdown in consumer discretionary demand would have an adverse impact on growth**

Watch business: Premiumisation focus positive, but susceptible to a slowdown

Titan is the market leader in the Rs38bn Indian watch market with a value and volume marketshare of 45% and 25% respectively. The company's focus is to strengthen its position in the premium segment, which is seeing the strongest growth and has the highest margins. However, the watch business is susceptible to weakness in consumer sentiment. We build in a slowdown in revenue growth in FY12 to 11% YoY despite addition of retail space.

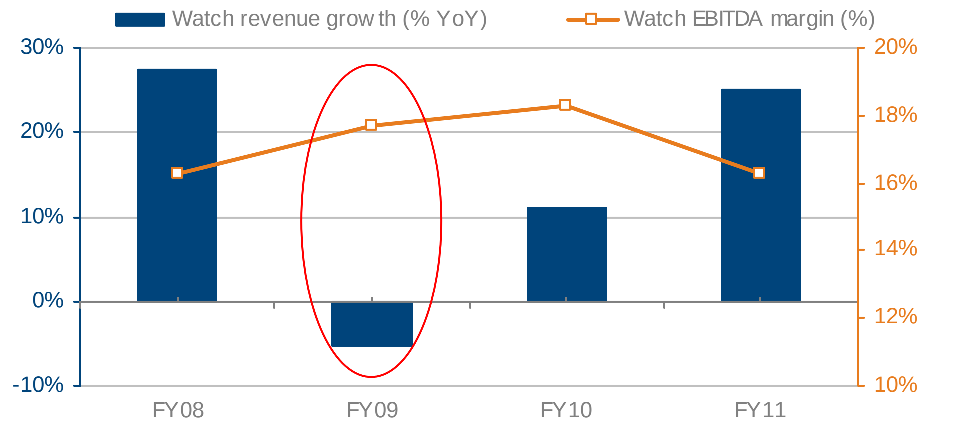
Focus on premium multi-brand format *Helios*

Titan's expansion plans for the watch business are focussed on *Helios*, which is the one of its kind multi-brand retail shop for premium watches. Management expects the premium watch segment, which is currently estimated at Rs6bn-7bn, to grow to more than Rs20bn by 2015, as consumers increasingly view watches as fashion accessories and not time devices. Titan looks to expand its *Helios* retail chain from 13 outlets now to 40 outlets by end-FY12. The majority of watches sold in this format would not be from the Titan stable. Being premium positioned, margins are expected to be high in this segment.

Slowdown could impact growth, but margins likely to improve

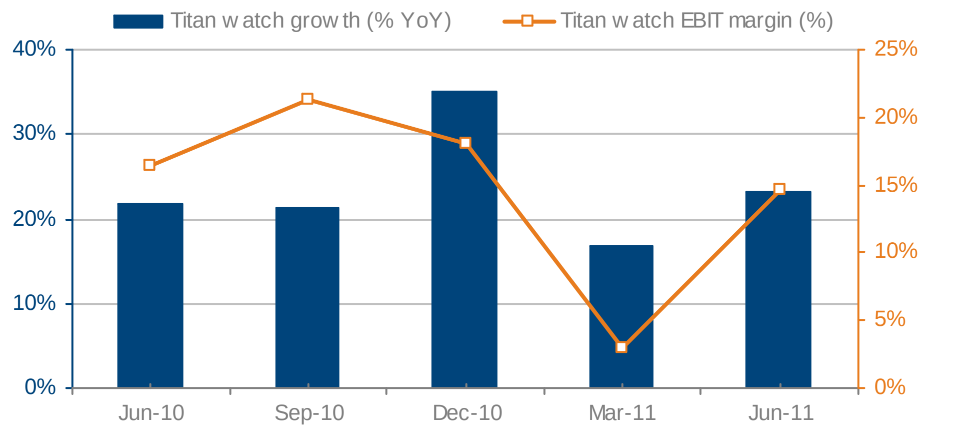
Titan's watch business is currently seeing a slowdown in the economy segment brand Sonata, in line with the experience in FY09 when consumer sentiment turned weak. However, growth in the mid-priced and premium segments is holding up strongly. We believe the premium segment is also susceptible to a slowdown, if consumer sentiment turns more negative. However, the watch division's margins are likely to improve due to slower growth in the economy segment, which would improve the sales mix in favour of the premium segments, similar to what was seen in FY09. We factor in a slowdown in growth in FY12 to 11% YoY, but factor in a marginal increase in EBITDA margin.

Figure 11: In FY09, the economic slowdown led to a decline in watch revenue, though margins expanded as the decline was in the economy segment



Source: Company, IIFL Research

Figure 12: Recent quarterly trend in watches has been volatile, but revenue growth has held above 15% YoY levels



Source: Company, IIFL Research

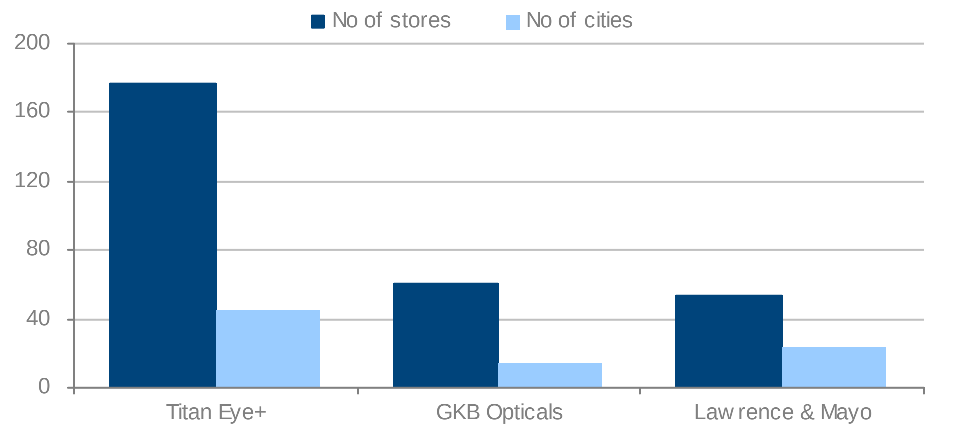
Eyewear: Promising business, great head start

Titan entered the prescription eyewear segment in FY07. Management estimates market size at Rs20-25bn in value and 25-30mn in volumes. According to management estimates, c30% of Indians need vision correction, out of which only 25% currently wear spectacles, which leaves a big room for penetration gain. Among current users, there is a clear trend of uptrading with consumers shifting to premium spectacles in frames and lenses. Both these factors are likely to help sustain 15-20% growth in the category. The market construct in this category is similar to that in jewellery marked by standalone unorganised players having an overwhelming majority market share and only a few small national chains.

Titan has become the dominant market leader within four years

While national branded eyewear retailers like GKB Optical and Lawrence & Mayo have been present for more than 50 years, Titan Eye+ has established a dominant lead over these players in retail presence within four years of entry. Now, Titan has three times more stores and presence in cities versus both these older national players.

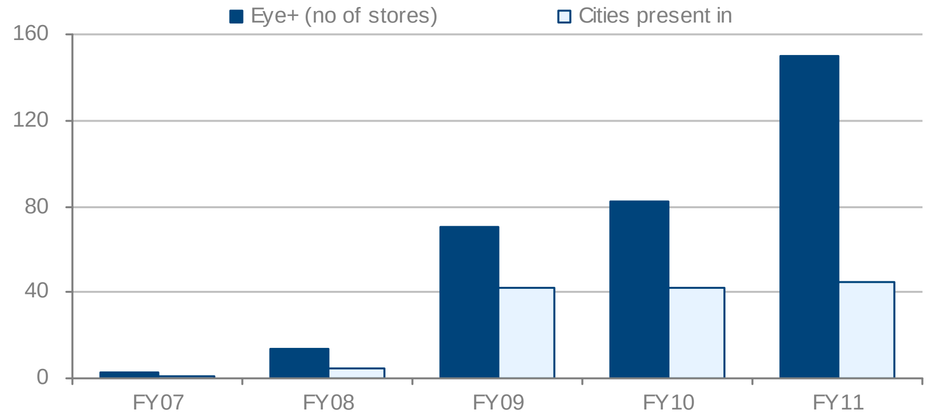
Figure 13: Titan is now a clear leader in branded prescription eyewear



Source: Company, IIFL Research

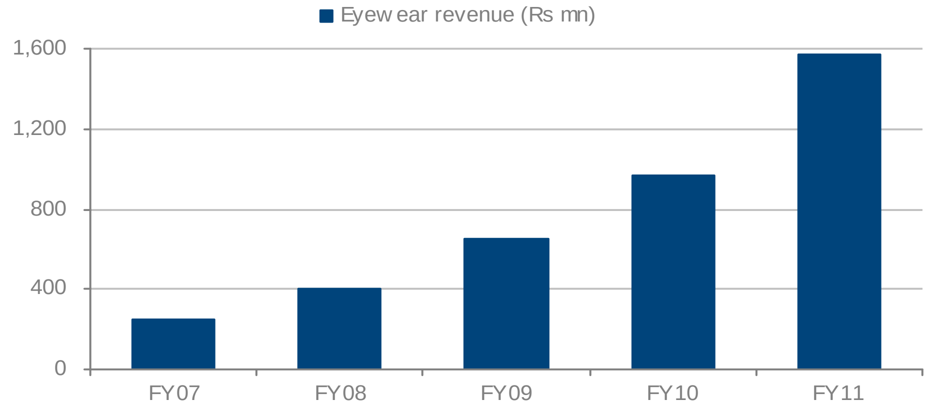
Business could see breakeven in FY13
The ramp up in store network has been accompanied by strong same store sales growth. The company saw 58% YoY growth in revenue in FY11, out of which 33% comprised same-store sales growth. The service mix has clearly found resonance with consumers.

Figure 14: Titan has expanded rapidly in the past three years in eyewear



Source: Company, IIFL Research

Figure 15: Eyewear revenue growth has been very strong



Source: Company, IIFL Research

Titan's turnover in prescription eyewear in FY11 was Rs1.56bn, which represents 5-7% of the estimated market, leaves a large headroom for growth over the coming years. A national advertising campaign and lack of competition have quickly established brand salience. Management expects to breakeven in FY13 in this format.

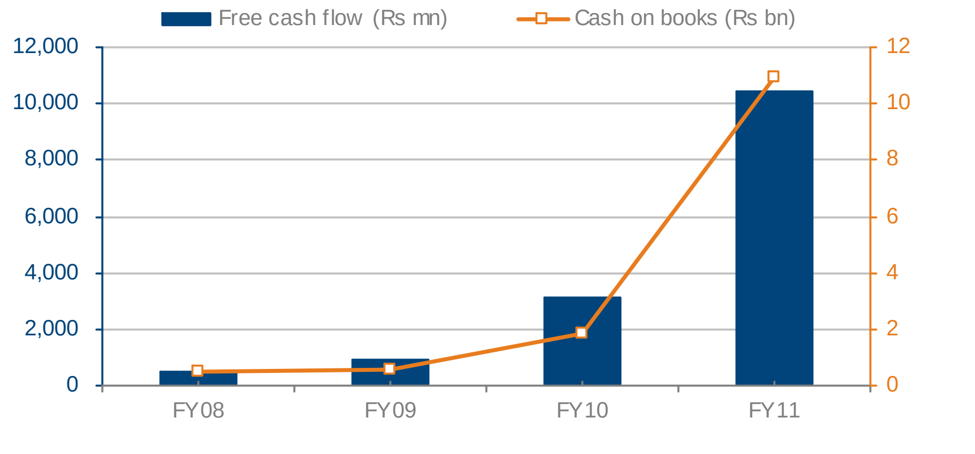
Fast Track: High potential youth brand

Titan launched the *Fastrack* brand in 2003 to launch watches targeting the college-going youth segment. The brand now extends to sunglasses, bags, wallets and other accessories. *Fastrack* has clearly established as a youth accessories brand and is likely to extend to a number of new accessories. Given the possibility of extensions in this brand, the management is looking at traditional retail distribution channels for the same. Currently, *Fastrack* has 43 branded outlets. However, the brand would need to reach to traditional multi-brand retail outlets to fulfil its potential.

Free cashflow, ROIC comparable to best-in-class Indian FMCG companies

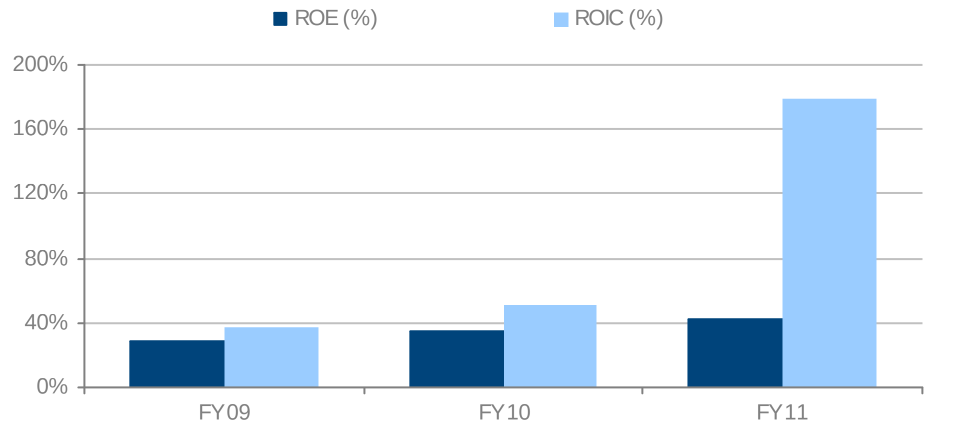
Titan's free cash flow increased from R3.1bn in FY10 to Rs10.4bn in FY11 and its ROIC increased from 51% in FY10 to 179% in FY11.

Figure 16: Free cash flow has seen a major spike in FY11



Source: Company, IIFL Research

Figure 17: ROIC increased in FY11, ROE growth is lower due to cash on books



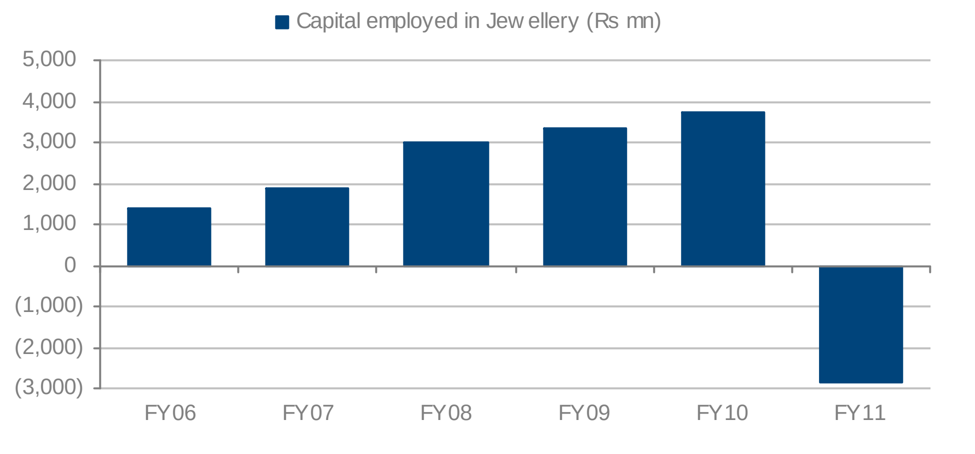
Source: Company, IIFL Research

This jump in return ratios and cash flow is driven by significant increase in share of the jewellery business and the 'Gold Harvest' scheme run by the company in the Jewellery division.

Tanishq enjoys six months gold lease whereas inventory is for four months

The key reason for *Tanishq's* high ROCE is that Titan secures gold on lease from banks and pays back after six months whereas its inventory of jewellery is c4 months. This creates negative working capital. As revenue increased at 40% CAGR over FY07-11, absolute negative working capital increased sharply compared with fixed assets, which have been largely static over the past two years as no meaningful store addition has taken place.

Figure 18: Jewellery division has moved to negative capital employed in FY11

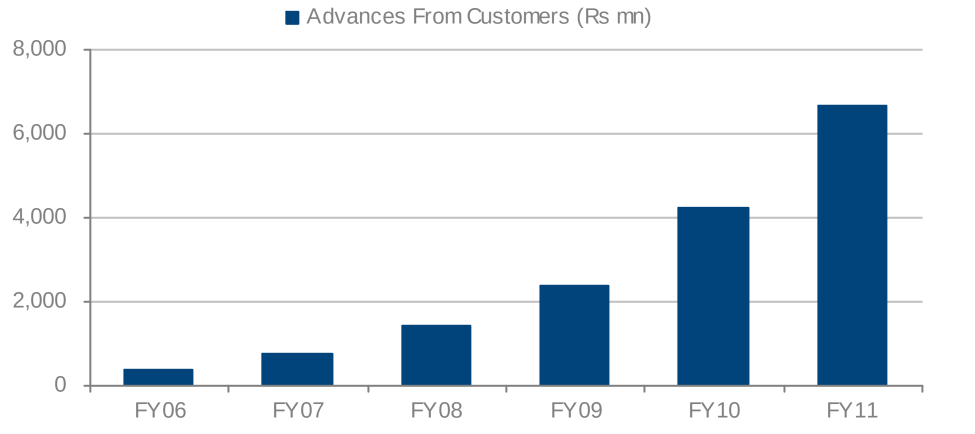


Source: Company, IIFL Research

Gold Harvest scheme has further lowered net working capital

Tanishq has aggressively focussed on the Gold Harvest scheme since FY09. Under this scheme, consumers deposit equal instalments of money every month for 11 months towards purchase of jewellery. In the 12th month *Tanishq* contributes one monthly instalment from its side, allowing the consumer to purchase jewellery worth 12 instalments from any *Tanishq* store. The rationale for the scheme for *Tanishq* was to lock in a consumer for 11-12 months before a large jewellery purchase decision. Further, the consumer perceives good annualised return of 16% on the value invested towards jewellery purchase.

Figure 19: Advances from customers from the 'Golden Harvest' scheme have grown strongly over the past two years



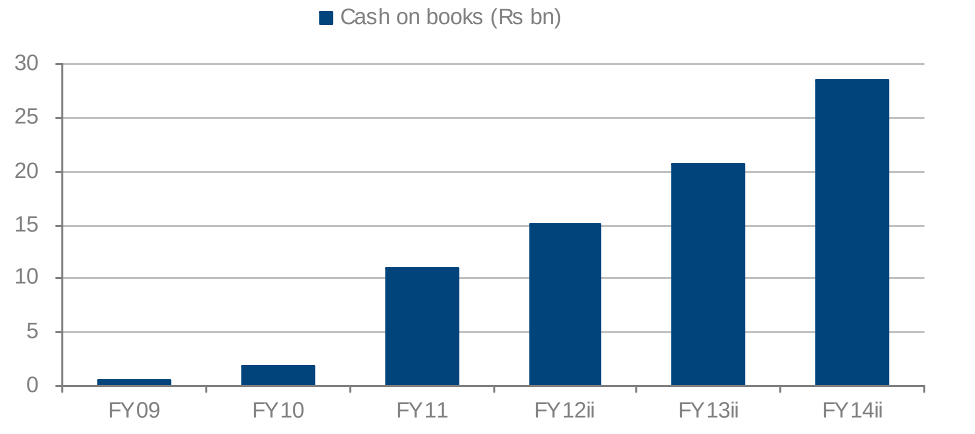
Source: Company, IIFL Research

Free cash flow to remain strong given contribution of the jewellery division would grow continuously and no significant CAPEX plans

We expect the jewellery business to continue increasing its share in Titan's overall business, which would imply continued strong operating cash flow led by negative working capital. We expect the jewellery division's share in revenue to increase from 76% in FY11 to 80% in FY13. Titan's overall CAPEX plans for the next 2-3 years are limited to Rs1.5-2bn a year, significantly lower than our estimated operating cash flow of Rs7-10bn over FY12-14.

Titan has maintained dividend payout ratio of c25% in the past three years. If this ratio does not increase, cash on books would keep increasing sharply in the next 2-3 years. The management is looking at a possible increase in dividend payout.

Figure 20: Cash on books will see a steep increase unless Titan increases dividend payout ratio



Source: Company, IIFL Research

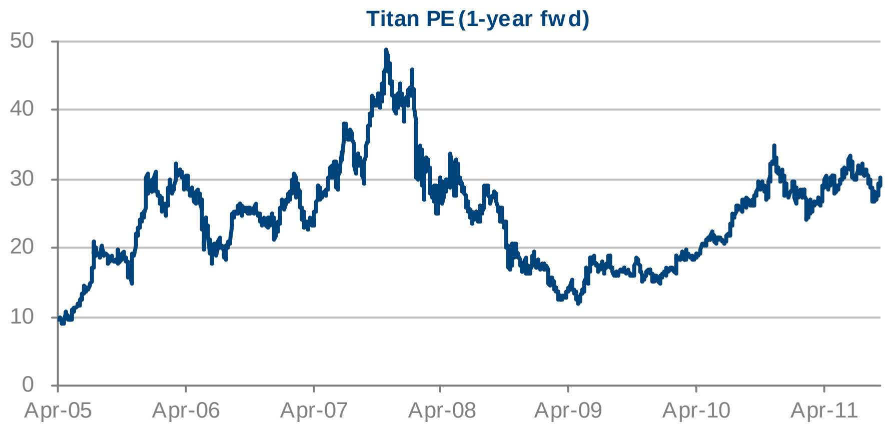
Valuation stretched, does not factor in near-term risks

Titan has traded in a wide range of 12-48x one-year forward earnings in the past five years. The average one-year forward P/E for the past five years has been 25.5x. Indian consumer discretionary stocks are trading at an average one-year forward P/E of 39x. Asian jewellery and discretionary retail stocks trade at an average one-year forward P/E of 20x.

We believe Titan's current valuations at 31x one-year forward earnings do not fully factor in near-term risks such as a steep fall in gold prices that would lead to negative operating leverage and slowdown in consumer discretionary spends in large cities due to slower salary growth and high inflation. We value Titan at 26x one-year forward P/E, in line with its past five-year trading average. We believe the high P/E multiple is justified given the maturity of the *Tanishq* brand, growth opportunity in Titan's focus categories, a high quality management and best-in-class FMCG return ratios, which make Titan a unique high-quality business in India.

We initiate with ADD and a target price of Rs232. Although near-term returns are capped, any meaningful correction in the stock price would be a good entry point for the stock.

Figure 21: Titan's one-year forward P/E history



Source: Company, IIFL Research

Figure 22: Comparable valuations

	MCAP (US $ mn)	P/E (FY12)	P/E (FY13)	ROE
Indian consumer discretionary				
JUBILANT FOODWORKS	1,207	53.2	36.0	45.9
SHOPPERS STOP	668	47.9	41.9	11.1
PAGE INDUSTRIES	633	36.0	27.6	52.6
LOVABLE LINGERIE	207	40.6	34.1	17.0
Asian Comparables				
LIFESTYLE INTL HLDGS LTD	4,756	22.2	18.9	21.1
SA SA INTERNATIONAL HLDGS	1,689	25.2	20.1	40.1
LUK FOOK HOLDINGS INTL LTD	2,428	24.3	16.1	34.1
CHOW SANG SANG HLDG	2,096	15.4	12.5	15.8
HENGDELI HOLDINGS LTD	1,985	17.3	13.6	15.4
FIYTA HOLDING-B	962	20.2	14.8	9.5
Global comparables				
BURBERRY GROUP PLC	8,745	26.3	20.8	32.0
BULGARI SPA	5,599	39.7	31.0	4.4
LVMH MOET HENNESSY LOUIS VUI	74,857	17.4	15.3	19.6
SWATCH GROUP AG/THE-REG	21,013	13.7	11.9	16.5
HERMES INTERNATIONAL	37,823	53.2	47.1	21.4
SIGNET JEWELERS LTD	3,099	13.4	10.1	11.0
CITIZEN HOLDINGS CO LTD	1,683	16.5	13.0	2.8
CHRISTIAN DIOR	23,664	13.5	11.9	18.1
TIFFANY & CO	8,890	24.3	18.7	18.1

Source: Company, IIFL Research

Assumptions

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Jewellery revenue growth (% YoY)	27	42	45	21	17
Watch revenue growth (% YoY)	11	25	10	15	15
Eyewear revenue growth (% YoY)	48	63	37	26	26
Jewellery EBITDA margin (%)	7.8	8.9	8.6	8.8	8.9
Watch EBITDA margin (%)	18.3	16.3	17.0	16.5	16.5

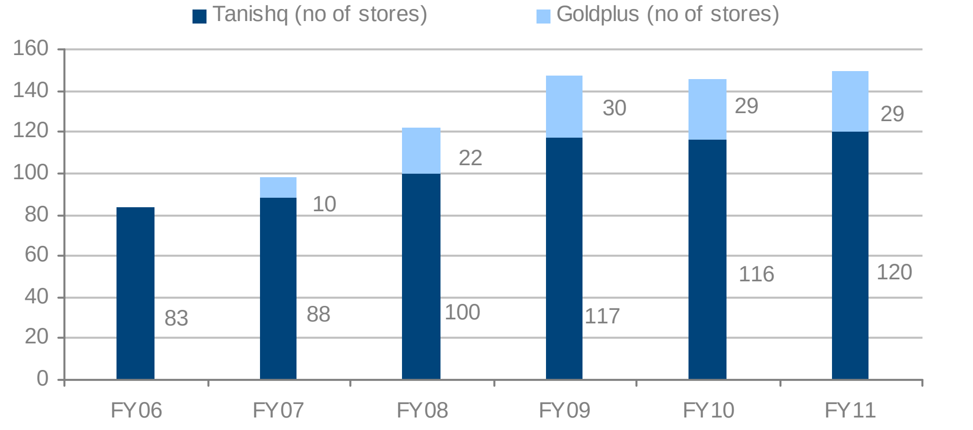
Source: Company data, IIFL Research

Annexure: Description of key formats

Jewellery business

The jewellery business comprises three formats – *Tanishq, Gold Plus* and *Zoya*. *Tanishq* is the mainstay of the business in terms of revenue, profit and space contribution. *Tanishq* consists of 120 stores covering 76 cities. *Gold Plus* targets the semi-urban and rural markets and sells primarily gold jewellery. This format has been struggling to meet its profitability targets. *Zoya* is a high-end designer jewellery format, which currently has just two stores.

Figure 23: Titan's jewellery store rollout



Source: Company, IIFL Research

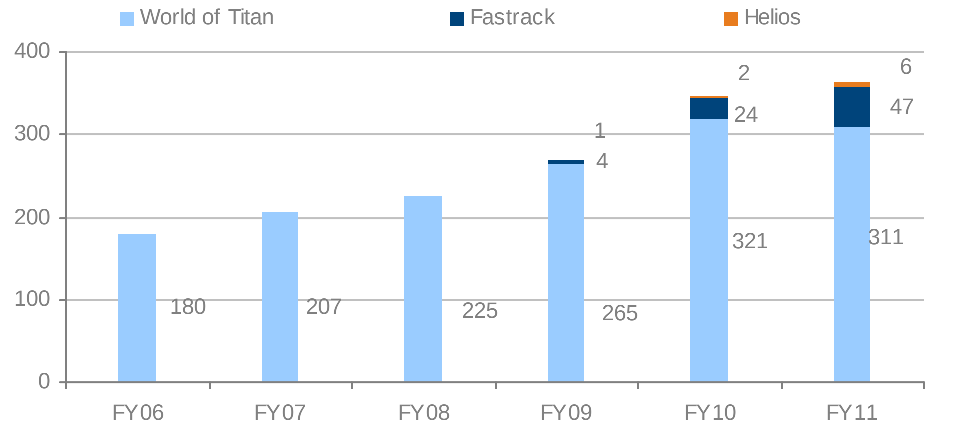
Some key aspects of the jewellery business

- **Over 2/3rd stores comprise franchisee operations:** Of the 2/3rd franchisee outlets, approximately half are outlets where Titan has inventory on its books while in the other half, the franchisee has inventory on its own books. In all franchisee outlets, the cost of retail space and store CAPEX are the responsibility of the franchisee. *Tanishq* is one of the few examples of successfully franchising the retail business.
- **Gold prices are hedged for more than 95% of purchases:** Titan takes gold on lease from banks for a maximum period of six months and fixes the gold price for repayment on a daily basis depending on actual daily sales run rate. This almost entirely takes care of hedging prices of gold used in making jewellery. The only component left un-hedged is gold left at the end of the six-month period of the total leased, for which Titan gets into forward contracts. The financing cost of hedging the gold is currently 3% per annum. This rate has remained reasonably stable over the past 4-5 years except in 2008-end when it jumped to 6-7% at the peak of the global economic crisis.
- **Making charges are a % of gold cost:** Prior to FY09, jewellery making charges in *Tanishq* were linked to the complexity of the jewellery piece. However, from FY09, making charges have been pegged as a % of the gold cost.

Watch business

The watch business has four distribution channels – dealers, *World of Titan* stores, and the *Helios*, *Fastrack* outlets. Titan has more than 11,000 dealers across the country. *World of Titan* stores are exclusive Titan stores. Helios, a recent thrust for the company, is a multi-brand retail format for premium watches.

Figure 24: Titan's watch business store rollout



Source: Company, IIFL Research

Financial summary

Income statement summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenue	46,744	65,209	88,124	108,199	128,999
EBITDA	3,950	5,856	7,780	9,311	11,414
EBIT	**3,349**	**5,511**	**7,343**	**8,794**	**10,843**
Net Interest expense	-254	-82	-82	-82	-82
Other Income	119	561	781	1,090	1,306
Profit before tax	3,213	5,990	8,042	9,801	12,067
Taxes	-681	-1,654	-2,220	-2,706	-3,331
Exceptional items	-29	-32	0	0	0
Net profit	**2,503**	**4,304**	**5,822**	**7,096**	**8,736**

Cash flow summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Profit before tax	3,213	5,990	8,042	9,801	12,067
Depr. & amortization	601	345	437	517	570
Tax paid	-815	-1,686	-2,220	-2,706	-3,331
Working capital Δ	558	6,445	1,096	960	995
Other operating items	-29	-32	0	0	0
Operating cashflow	3,528	11,062	7,355	8,573	10,301
Capital expenditure	-410	-620	-1,500	-1,500	-1,000
Free cash flow	**3,118**	**10,442**	**5,855**	**7,073**	**9,301**
Equity raised	21	12	16	16	16
Investments	0	-15	0	0	0
Debt financing/disposal	-1,026	-51	0	0	0
Dividends paid	-793	-1,306	-1,761	-2,142	-2,634
Net change in cash	**1,320**	**9,082**	**4,111**	**4,946**	**6,683**

Source: Company data, IIFL Research

Balance sheet summary (Rs m)

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Cash & equivalents	1,867	10,949	15,060	20,006	26,689
Sundry debtors	936	1,137	1,536	1,886	2,249
Inventories - trade	13,403	19,938	26,945	33,083	39,443
Other current assets	1,831	2,200	2,973	3,650	4,352
Fixed assets	2,749	3,024	4,087	5,070	5,499
Other term assets	76	91	91	91	91
Total assets	**20,863**	**37,340**	**50,692**	**63,787**	**78,324**
Short-term debt	0	0	0	0	0
Sundry creditors	11,496	24,193	32,694	40,142	47,859
Other current liabs	1,347	2,201	2,974	3,652	4,354
Long-term debt/CBs	728	677	677	677	677
Other long-term liabs	48	15	15	15	15
Net worth	**7,244**	**10,254**	**14,331**	**19,301**	**25,419**
Total liabs & equity	**20,863**	**37,340**	**50,692**	**63,787**	**78,324**

Ratio analysis

Y/e 31 Mar	FY10A	FY11A	FY12ii	FY13ii	FY14ii
Revenue growth (%)	22.9	39.5	35.1	22.8	19.2
Op Ebitda growth (%)	33.3	48.3	32.9	19.7	22.6
Op Ebit growth (%)	31.6	64.6	33.2	19.8	23.3
Op Ebitda margin (%)	8.4	9.0	8.8	8.6	8.8
Op Ebit margin (%)	7.2	8.5	8.3	8.1	8.4
Net profit margin (%)	5.4	6.6	6.6	6.6	6.8
Dividend payout (%)	31.7	30.3	30.2	30.2	30.2
Tax rate (%)	21.2	27.6	27.6	27.6	27.6
Net debt/equity (%)	-15.7	-100.2	-100.4	-100.1	-102.3
Net debt/op Ebitda (x)	-0.3	-1.8	-1.8	-2.1	-2.3
Return on equity (%)	34.6	42.0	40.6	36.8	34.4

Source: Company data, IIFL Research

Key to our recommendation structure

BUY - Absolute - Stock expected to give a positive return of over 20% over a 1-year horizon.
SELL - Absolute - Stock expected to fall by more than 10% over a 1-year horizon.

In addition, **Add** and **Reduce** recommendations are based on expected returns relative to a hurdle rate. Investment horizon for **Add** and **Reduce** recommendations is up to a year. We assume the current hurdle rate at 10%, this being the average return on a debt instrument available for investment.

Add - Stock expected to give a return of 0-10% over the hurdle rate, ie a positive return of 10%+.
Reduce - Stock expected to return less than the hurdle rate, ie return of less than 10%.

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