

Titan Company (TTAN IN)

Glitter missing

INDIA | FMCG | Quarterly Update

2 November 2015

Top takeaways from Q2FY16

- ✖ Topline was significantly lower than our/consensus estimates
- ✖ While jewellery was expected to show a decline, significantly higher like-to-like (LTL) decline in Tanishq (40%) and sluggish LTL growth in watches (-4%) and eyewear (1%) were negative surprises.
- ⇒ Jewellery margins were the lowest in six years due to negative operating leverage while watches margins showed some improvement
- ⇒ Apart from weak consumer sentiment, the quarter was impacted by premature redemption last year in Gold Harvest Scheme (GHS) and late kicking off of festival season this year

Key highlights: Consolidated net sales declined by 26% yoy to Rs 26.7bn vs. our/consensus estimates of Rs 29.5bn/29.3bn. Gold prices were down by 7% yoy. Jewellery grammage declined by 10% yoy and watches volumes were flat.

Conference call takeaways

- ⇒ As per the management, the quarter started well with demand picking up in July/August, but growth lost steam in September. Late onset of festival season affected sales growth this quarter, however, Dushera sales were encouraging and grew by 20%.
- ⇒ GHS scheme has seen incremental instalments of Rs 90-100mn from new customers; GHS to contribute to Rs 4-4.5bn sales in Q3/Q4 FY16.
- ⇒ Jewellery gross margins were maintained despite reduced making charges and poorer studded share (24% vs. 35% last year) due to high share of low margin GHS last year
- ⇒ In watches, exports have contributed more to growth than domestic markets, and in domestic markets, retail has done better in small towns vs. large towns due to higher competition of e-commerce in larger towns.
- ✖ Watches inventory has piled up due to sluggish sales and should clear in two quarters.
- ✓ In watches, the ticket size has improved and repeat customer sales have also increased
- ⇒ Precision engineering business saw decline in sales because of a huge order in base
- ✓ Gold requirement is sourced 50/50 from gold on lease/spot buy; gold on lease rate has been significantly lower than vs. last 4-5 months
- ✖ Possibility of implementation of PAN card requirement for sales above Rs 100,000 still remains, as the government is focused on reigning in black-market transactions.

Outlook and valuation: Subdued results of the past two quarters indicate Titan's high reliance on GHS for growth. We expect the jewellery segment to struggle for the next few quarters because of regulatory issues in GHS and subdued gold prices and demand. We have cut our estimates for FY16/17 to incorporate slower growth in jewellery/watches. We value the stock at Rs 340 (Rs 395 earlier) with a target multiple of 30x FY17 earnings. Due to limited upside and chances of negative surprises, we maintain Neutral.

Neutral (Maintain)

CMP RS 350 / TARGET RS 340 (-3%)

COMPANY DATA

| | |
|------------------------|-----------|
| O/S SHARES (MN) : | 888 |
| MARKET CAP (RSBN) : | 307 |
| MARKET CAP (USDBN) : | 4.7 |
| 52 - WK HI/LO (RS) : | 448 / 303 |
| LIQUIDITY 3M (USDMN) : | 6.5 |
| PAR VALUE (RS) : | 1 |

SHARE HOLDING PATTERN, %

| | Jun 15 | Mar 15 | Dec 14 |
|-------------------|--------|--------|--------|
| PROMOTERS : | 53.1 | 53.1 | 53.1 |
| FII / NRI : | 21.6 | 21.6 | 21.6 |
| FI / MF : | 3.2 | 3.2 | 2.9 |
| NON PRO : | 10.3 | 10.6 | 10.5 |
| PUBLIC & OTHERS : | 11.9 | 11.6 | 12.0 |

Key Financials

| Rs mn | FY15 | FY16E | FY17E |
|--------------|---------|---------|---------|
| Net Sales | 119,134 | 121,020 | 138,129 |
| EBIDTA | 11,485 | 11,436 | 13,744 |
| Net Profit | 8,162 | 8,020 | 10,034 |
| EPS, Rs | 9.2 | 9.0 | 11.3 |
| PER, x | 38.1 | 38.7 | 31.0 |
| EV/EBIDTA, x | 27.0 | 26.2 | 20.7 |
| ROE, % | 28.9 | 23.7 | 24.9 |

CHANGE IN ESTIMATES

| | Revised Est. | | % Revision | |
|----------|--------------|---------|------------|--------|
| Rs bn | FY16E | FY17E | FY16E | FY17E |
| Revenue | 121,020 | 138,129 | -10.4% | -14.2% |
| EBITDA | 11,436 | 13,744 | -11.8% | -14.6% |
| Core PAT | 8,020 | 10,034 | -12.4% | -14.1% |
| EPS (Rs) | 9.0 | 11.3 | -12.3% | -14.4% |

Naveen Kulkarni and Jubil Jain

| (Rs mn) | Q2FY16 | Q1FY16 | qoq growth % | Q2FY15 | yoy growth % | vs. expectations % | Comments |
|--------------------------|--------|--------|--------------|--------|--------------|--------------------|--|
| Net Sales | 26,547 | 26,867 | -1 | 35,647 | -26 | -9 | Missed estimates due to weak demand, high base and delayed festival season this year |
| Gross Profits | 6,961 | 7,809 | -11 | 8,818 | -21 | -18 | |
| Gross Margin (%) | 26.2 | 29.1 | -284 bps | 24.7 | 148 bps | -300 bps | |
| Staff costs | 1,800 | 1,756 | 2 | 1,639 | 10 | 2 | |
| Ad spends | 895 | 1,288 | -31 | 1,058 | -15 | -5 | Cut on ad spends in Q2 because of delayed festival season |
| Other operating expenses | 2,238 | 2,537 | -12 | 2,790 | -20 | -5 | |
| EBITDA | 2,028 | 2,227 | -9 | 3,331 | -39 | -41 | Impacted by negative operating leverage |
| EBITDA margin (%) | 7.6 | 8.3 | -65 bps | 9.3 | -171 bps | -426 bps | Impacted by negative operating leverage |
| PBT | 1,815 | 2,036 | -11 | 3,201 | -43 | -45 | |
| Tax rate (%) | 19.9 | 25.8 | -592 bps | 25.0 | -514 bps | -611 bps | Tax rate guidance of 24% for FY16 |
| PAT | 1,454 | 1,511 | -4 | 2,400 | -39 | -40 | |

Segment- wise performance

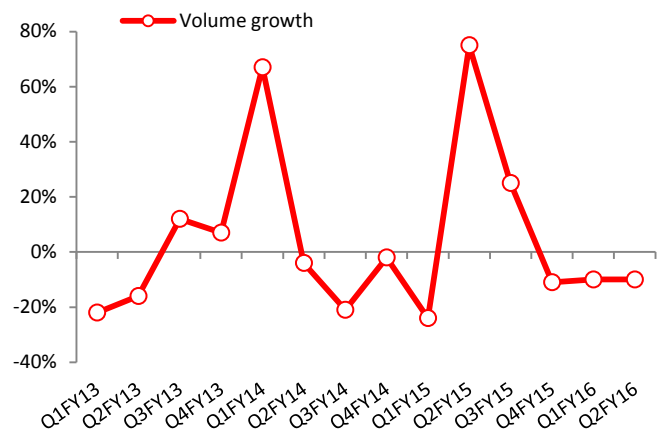
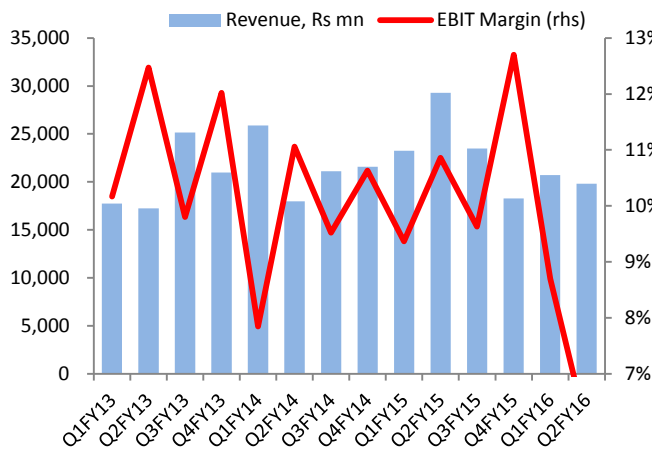
| | Q2FY16 | Q1FY16 | QoQ | Q2FY15 | YoY |
|------------------|--------|--------|------|--------|------|
| Jewellery | | | | | |
| Revenue (Rs mn) | 19,817 | 20,720 | -4% | 29,294 | -32% |
| EBIT (Rs mn) | 1,191 | 1,803 | -34% | 3,182 | -63% |
| EBIT Margin (%) | 6.0% | 8.7% | | 10.9% | |
| Watches | | | | | |
| Revenue (Rs mn) | 5,465 | 4,845 | 13% | 5,275 | 4% |
| EBIT (Rs mn) | 838 | 481 | 74% | 666 | 26% |
| EBIT Margin (%) | 15.3% | 9.9% | | 12.6% | |

Source: Company, PhillipCapital India Research

Jewellery Division Performance

Revenue decline of -32% (YoY) led to negative operating leverage

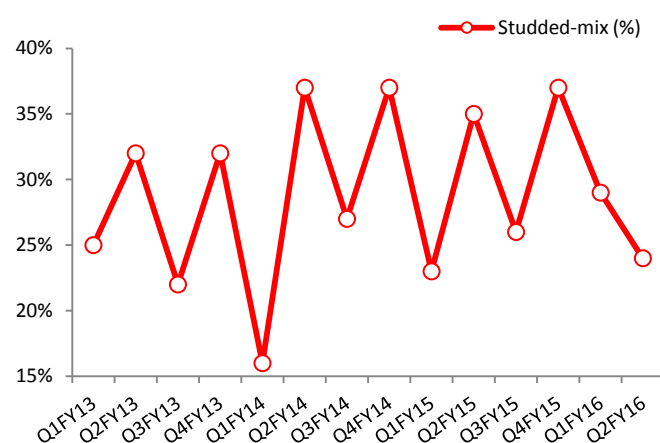
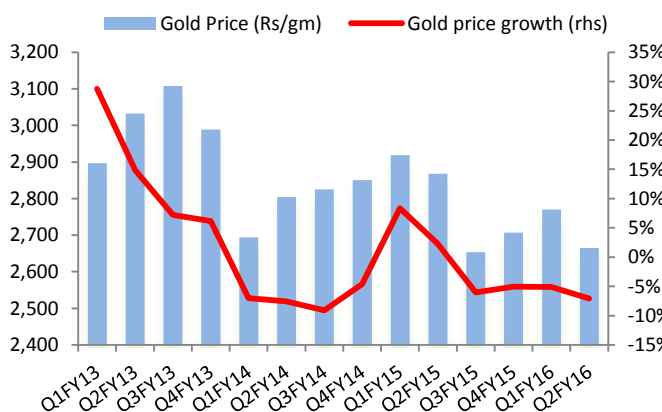
Volume growth of -10% (YoY)



Source: Company, PhillipCapital India Research

Gold price decreased by 7% (YoY)

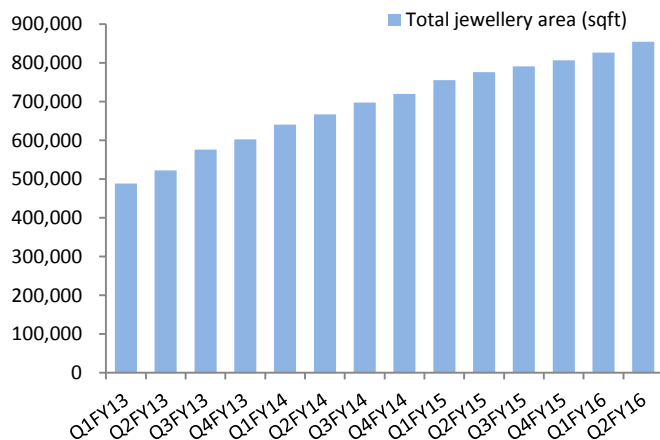
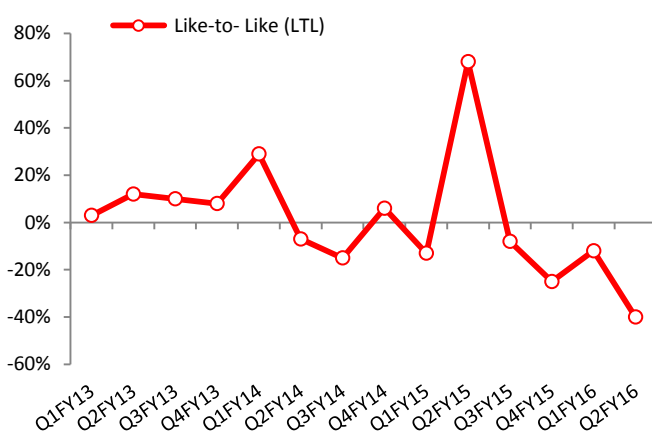
Studded mix fell to 24%



Source: Company, PhillipCapital India Research

Tanishq LTL growth of -40% led to revenue miss

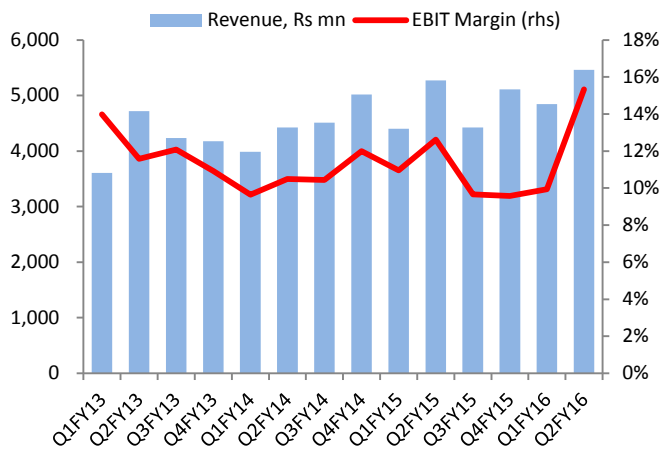
Company added ~28K area in Jewellery segment



Source: Company, PhillipCapital India Research

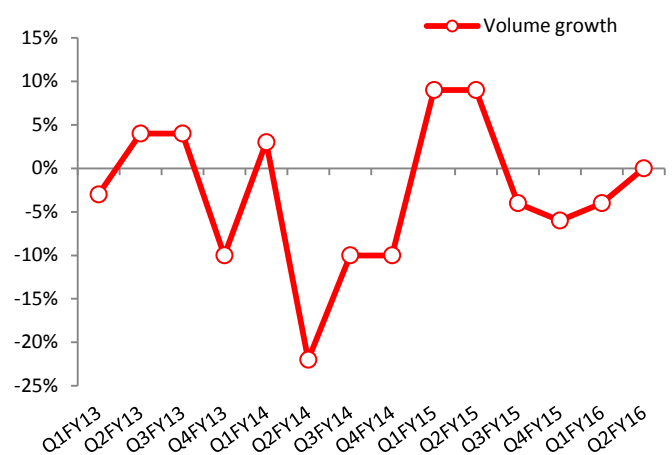
Watches Division Performance

Revenue grew by 3.6% (YoY); margins expanded by 270 bps



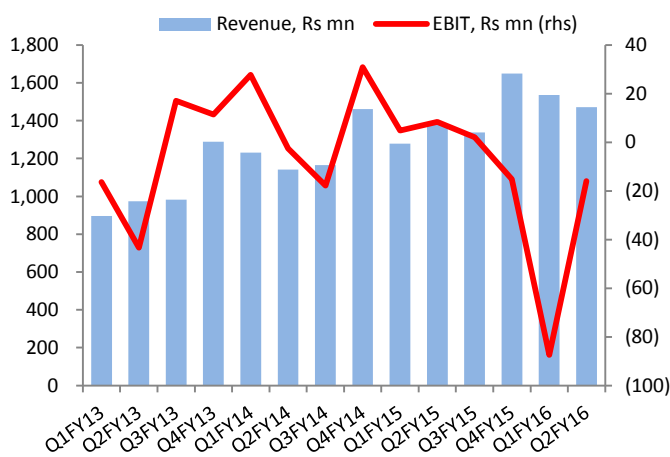
Source: Company, PhillipCapital India Research

Volume Growth was flat (YoY)



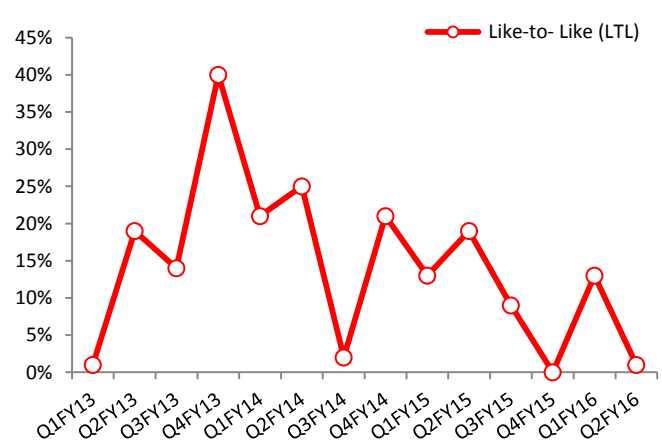
Others Division Performance – EYEWEAR

The eyewear segment continues to grow



Source: Company, PhillipCapital India Research

LTL growth a concern



Financials

Income Statement

| Y/E Mar, Rs mn | FY14 | FY15 | FY16e | FY17e |
|---------------------------------|----------------|----------------|----------------|----------------|
| Net sales | 109,274 | 119,134 | 121,020 | 138,129 |
| Growth, % | 8 | 9 | 2 | 14 |
| Total income | 109,274 | 119,134 | 121,020 | 138,129 |
| Raw material expenses | -80,519 | -87,515 | -88,950 | -101,179 |
| Employee expenses | -5,404 | -6,325 | -6,354 | -7,183 |
| Other Operating expenses | -12,908 | -13,810 | -14,280 | -16,023 |
| EBITDA (Core) | 10,443 | 11,485 | 11,436 | 13,744 |
| Growth, % | 3.1 | 10.0 | (0.4) | 20.2 |
| Margin, % | 9.6 | 9.6 | 9.5 | 10.0 |
| Depreciation | -675 | -898 | -1,072 | -1,212 |
| EBIT | 9,768 | 10,587 | 10,364 | 12,531 |
| Growth, % | 2.1 | 8.4 | (2.1) | 20.9 |
| Margin, % | 8.9 | 8.9 | 8.6 | 9.1 |
| Interest paid | -871 | -807 | -403 | -691 |
| Other Non-Operating Income | 1,202 | 708 | 591 | 1,719 |
| Pre-tax profit | 10,097 | 10,488 | 10,553 | 13,560 |
| Tax provided | -2,751 | -2,325 | -2,533 | -3,526 |
| Profit after tax | 7,346 | 8,162 | 8,020 | 10,034 |
| Others (Minorities, Associates) | 0 | 0 | 0 | 0 |
| Net Profit | 7,346 | 8,162 | 8,020 | 10,034 |
| Growth, % | 1.4 | 11.1 | (1.7) | 25.1 |
| Net Profit (adjusted) | 7,346 | 8,162 | 8,020 | 10,034 |
| Unadj. shares (m) | 888 | 888 | 888 | 888 |
| Wtd avg shares (m) | 888 | 888 | 888 | 888 |

Balance Sheet

| Y/E Mar, Rs mn | FY14 | FY15e | FY16e | FY17e |
|---------------------------------------|---------------|---------------|---------------|---------------|
| Cash & bank | 8,927 | 2,123 | 10,670 | 25,599 |
| Debtors | 1,541 | 1,897 | 1,989 | 2,271 |
| Inventory | 38,694 | 40,493 | 40,210 | 45,739 |
| Loans & advances | 5,357 | 6,398 | 4,841 | 5,525 |
| Total current assets | 54,519 | 51,282 | 57,711 | 79,135 |
| Investments | 31 | 31 | 31 | 31 |
| Gross fixed assets | 11,319 | 13,288 | 15,319 | 17,319 |
| Less: Depreciation | -5,177 | -6,074 | -7,147 | -8,359 |
| Add: Capital WIP | 329 | 329 | 329 | 329 |
| Net fixed assets | 6,471 | 7,543 | 8,501 | 9,289 |
| Total assets | 61,114 | 59,052 | 66,440 | 88,651 |
| Current liabilities | 27,813 | 26,843 | 30,023 | 44,548 |
| Total current liabilities | 27,813 | 26,843 | 30,023 | 44,548 |
| Non-current liabilities | 8,074 | 1,001 | 3 | 3 |
| Total liabilities | 35,887 | 27,844 | 30,026 | 44,551 |
| Paid-up capital | 888 | 888 | 888 | 888 |
| Reserves & surplus | 24,340 | 30,321 | 35,525 | 43,212 |
| Shareholders' equity | 25,227 | 31,208 | 36,413 | 44,100 |
| Total equity & liabilities | 61,114 | 59,052 | 66,440 | 88,651 |

Source: Company, PhillipCapital India Research Estimates

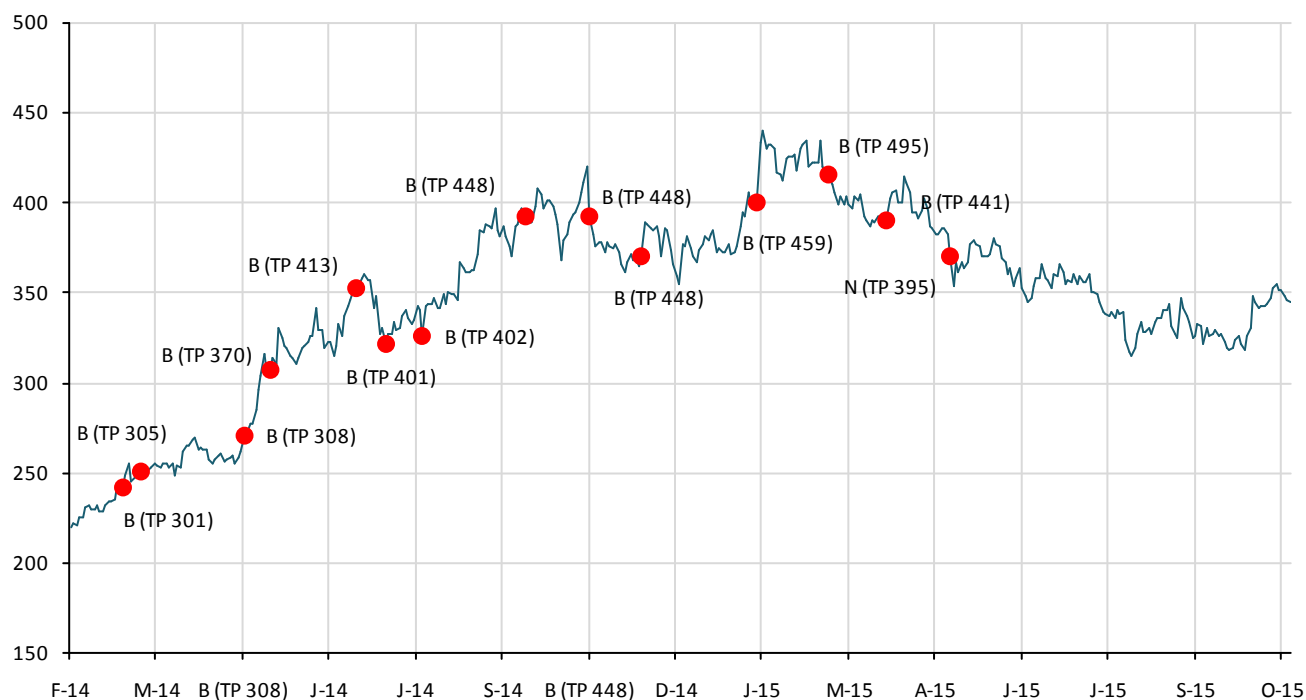
Cash Flow

| | FY14 | FY15e | FY16e | FY17e |
|--|---------------|---------------|---------------|---------------|
| Pre-tax profit | 10,097 | 10,488 | 10,553 | 13,560 |
| Depreciation | 675 | 898 | 1,072 | 1,212 |
| Chg in working capital | -14,575 | -4,536 | 5,297 | 8,031 |
| Total tax paid | -2,761 | -2,431 | -2,533 | -3,526 |
| Cash flow from operating activities | -6,563 | 4,419 | 14,389 | 19,277 |
| Capital expenditure | -1,729 | -1,969 | -2,031 | -2,000 |
| Chg in investments | -2 | 0 | 0 | 0 |
| Cash flow from investing activities | -1,733 | -1,969 | -2,031 | -2,000 |
| Free cash flow | -8,296 | 2,449 | 12,359 | 17,277 |
| Debt raised/(repaid) | 8,008 | -7,071 | -998 | 0 |
| Dividend (incl. tax) | -2,181 | -2,181 | -2,815 | -2,348 |
| Cash flow from financing activities | 5,827 | -9,252 | -3,813 | -2,348 |
| Net chg in cash | -2,469 | -6,803 | 8,546 | 14,929 |

Valuation Ratios

| | FY14 | FY15e | FY16e | FY17e |
|--------------------------------|-------|-------|--------|--------|
| Per Share data | | | | |
| EPS (INR) | 8.3 | 9.2 | 9.0 | 11.3 |
| Growth, % | 1.4 | 11.1 | (1.7) | 25.1 |
| Book NAV/share (INR) | 28.4 | 35.2 | 41.0 | 49.7 |
| FDEPS (INR) | 8.3 | 9.2 | 9.0 | 11.3 |
| CEPS (INR) | 9.0 | 10.2 | 10.2 | 12.7 |
| CFPS (INR) | (8.7) | 4.2 | 15.5 | 19.8 |
| DPS (INR) | 2.1 | 2.1 | 2.7 | 2.3 |
| Return ratios | | | | |
| Return on assets (%) | 13.7 | 14.9 | 13.4 | 13.8 |
| Return on equity (%) | 32.7 | 28.9 | 23.7 | 24.9 |
| Return on capital employed (%) | 31.0 | 27.4 | 24.5 | 26.6 |
| Turnover ratios | | | | |
| Asset turnover (x) | 6.7 | 4.4 | 4.4 | 6.3 |
| Sales/Total assets (x) | 1.8 | 2.0 | 1.9 | 1.8 |
| Sales/Net FA (x) | 19.0 | 17.0 | 15.1 | 15.5 |
| Working capital/Sales (x) | 0.2 | 0.2 | 0.1 | 0.1 |
| Fixed capital/Sales (x) | 5.1 | 5.8 | 6.0 | 6.0 |
| Working capital days | 59.4 | 68.4 | 51.3 | 23.8 |
| Liquidity ratios | | | | |
| Current ratio (x) | 2.0 | 1.9 | 1.9 | 1.8 |
| Quick ratio (x) | 0.6 | 0.4 | 0.6 | 0.7 |
| Interest cover (x) | 11.2 | 13.1 | 25.7 | 18.1 |
| Dividend cover (x) | 3.9 | 4.4 | 3.3 | 5.0 |
| Total debt/Equity (%) | 32.0 | 3.2 | - | - |
| Net debt/Equity (%) | (3.4) | (3.6) | (29.3) | (58.0) |
| Valuation | | | | |
| PER (x) | 42.3 | 38.1 | 38.7 | 31.0 |
| Price/Book (x) | 30.4 | 3.4 | (22.2) | 1.2 |
| Yield (%) | 12.3 | 10.0 | 8.5 | 7.0 |
| EV/Net sales (x) | 0.6 | 0.6 | 0.8 | 0.6 |
| EV/EBITDA (x) | 2.8 | 2.6 | 2.5 | 2.1 |
| EV/EBIT (x) | 29.7 | 27.0 | 26.2 | 20.7 |

Stock Price, Price Target and Rating History



Rating Methodology

We rate stock on absolute return basis. Our target price for the stocks has an investment horizon of one year.

| Rating | Criteria | Definition |
|---------|-----------------------------|---|
| BUY | $\geq +15\%$ | Target price is equal to or more than 15% of current market price |
| NEUTRAL | $-15\% > \text{to} < +15\%$ | Target price is less than +15% but more than -15% |
| SELL | $\leq -15\%$ | Target price is less than or equal to -15%. |

Management

| | |
|---|-------------------|
| Vineet Bhatnagar (Managing Director) | (91 22) 2300 2999 |
| Kinshuk Bharti Tiwari (Head – Institutional Equity) | (91 22) 6667 9946 |
| Jignesh Shah (Head – Equity Derivatives) | (91 22) 6667 9735 |

Research
Automobiles

| | |
|--------------------|------------------|
| Dhawal Doshi | (9122) 6667 9769 |
| Nitesh Sharma, CFA | (9122) 6667 9965 |

Agri Inputs

| | |
|-------------|------------------|
| Gauri Anand | (9122) 6667 9943 |
|-------------|------------------|

Banking, NBFCs

| | |
|------------------|------------------|
| Manish Agarwalla | (9122) 6667 9962 |
| Pradeep Agrawal | (9122) 6667 9953 |
| Pareesh Jain | (9122) 6667 9948 |

Consumer, Media, Telecom

| | |
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| Naveen Kulkarni, CFA, FRM | (9122) 6667 9947 |
| Jubil Jain | (9122) 6667 9766 |
| Manoj Behera | (9122) 6667 9973 |

Cement

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Economics

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| Anjali Verma | (9122) 6667 9969 |
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Engineering, Capital Goods

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Infrastructure & IT Services

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| Deepan Kapadia | (9122) 6667 9992 |

Logistics, Transportation & Midcap

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| Vikram Suryavanshi | (9122) 6667 9951 |
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Metals

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| Yash Doshi | (9122) 6667 9987 |

Oil & Gas

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| Sabri Hazarika | (9122) 6667 9756 |
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Pharma

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Midcap

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Portfolio Strategy

| | |
|-----------------|------------------|
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Technicals

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| Subodh Gupta, CMT | (9122) 6667 9762 |
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Production Manager

| | |
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| Ganesh Deorukhkar | (9122) 6667 9966 |
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Database Manager

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Editor

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| Roshan Sony | 98199 72726 |
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Sr. Manager – Equities Support

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Sales & Distribution

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| Ashvin Patil | (9122) 6667 9991 |
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| Kishor Binwal | (9122) 6667 9989 |
| Sidharth Agrawal | (9122) 6667 9934 |
| Bhavin Shah | (9122) 6667 9974 |

Sales Trader

| | |
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| Dilesh Doshi | (9122) 6667 9747 |
| Suniil Pandit | (9122) 6667 9745 |

Execution

| | |
|------------|------------------|
| Mayur Shah | (9122) 6667 9945 |
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Corporate Communications

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| Zarine Damania | (9122) 6667 9976 |
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