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Stock Update

Titan Company Limited

Jewellery business back on track

Consumer Discretionary	Sharekhan code: TITAN	Result Update

3R MATRIX

	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)		✓	

\+ Positive = Neutral - Negative

Reco/View	Change
Reco: **Buy**	↔
CMP: **Rs. 1,218**	
Price Target: **Rs. 1,350**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

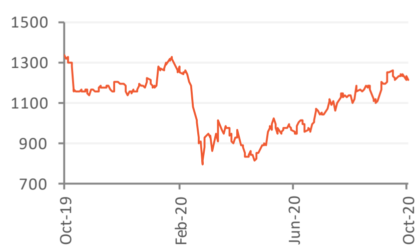
Company details

Market cap:	Rs. 1,08,123 cr
52-week high/low:	Rs. 1,345/720
NSE volume: (No of shares)	36.1 lakh
BSE code:	500114
NSE code:	TITAN
Free float: (No of shares)	41.8 cr

Shareholding (%)

Promoters	52.9
FII	18.7
DII	11.5
Others	16.9

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	6.9	15.8	30.6	-7.4
Relative to Sensex	1.8	12.1	6.3	-7.6

Sharekhan Research, Bloomberg

Summary

- Titan's standalone business recovered to 89% (consolidated recovered to 98%) with the jewellery business growing by 9% in Q2FY2021; watches and eyewear business recoveredto 56% and 61%, respectively.
- Consolidated OPM declined 433 bps to 6.9%, affected by hedging loss and lower operating leverge. Operating profit was down 40% to Rs. 313 crore.
- Higher demand during the festive season and improving wedding demand will help Titan post sustained recovery in the jewellery business going ahead.
- We have fine-tuned our estimates for FY2021 to factor in lower-than-expected OPM. We have maintained them for FY2022/FY2023E. We maintain Buy with a revised PT of Rs. 1,350.

Titan Company's (Titan) consolidated revenue decreased by 2.3% to Rs. 4,553 crore as against our expectation of Rs. 4175.7 crore. This is including the gold-ingots sale of Rs. 391 crore. Revenue of the jewellery business grew by 9%, while watches and eye wear businesses recovered to 56% and 61%, respectively, in Q2 (both the businesses recovered to 70% each in September 2020). Operating profit margin (OPM) decreased by 433 bps to 6.9% as against our expectation of 7.5%. During the quarter, the company has recognised loss of Rs. 484 crore against cash flow hedging, which affected OPM substantially. During Q1FY2021, it was Rs. 205 crore. With the jewellery business expected to post sequential improvement and watches and eyewear business inching close to pre-covid levels (likely to reach 70%-75% in Q3FY2021 and full recovery by Q4FY2021), profitability would improve in the coming quarters. Further, management indicated that hedging contract will expire by October 2020/November 2020 and will change the hedging policy, which will help in reducing the impact of ineffective hedges going forward.The cash and cash equivalent increased by Rs. 382 crore to Rs. 877 crore in the past six months mainly on account of stringent working capital management. Market share gains from small jewelers and higher festive/wedding demand would help the jewellery business to post good performance in the coming quarters. The watches and eyewear division has seen sequential improvement and would continue to benefit from higher sales through the online platform. Thus, strong recovery is anticipated in FY2022 with OPM coming back on track.

Key positives

- Jewellery sales grew by high single digits during 11 days of the festive season.
- Eyewear posted EBIT of Rs. 9 crore at 61% of business recovery.
- Titan targets to open 34 Tanishq stores in FY2021.

Key negatives

- Ineffective hedges resulted in a sharp decline in OPM.

Our Call

Retained Buy with a revised PT of Rs. 1,350: We have fine-tuned our estimates for FY2021 to factor in lower-than-expected OPM, while we have maintained them for FY2022/FY2023E. Titan posted good recovery in Q2FY2021 with 98% of the business recovering to pre-covid levels. Overall, we expect Titan to benefit from people shifting to trusted brands and market share gains. This, along with a relatively stable balance sheet, makes it a better play in the retail space. We have a Buy recommendation on the stock with a revised price target (PT) of Rs. 1,350. The stock is currently trading at 50.7x and 42.9x its FY2022/FY2023E EPS (EV/EBIDTA of 32.4x/27.5xits FY2022/ FY2023E).

Key risk

Any disruption in the recovery of jewellery business would act as key risk to our earnings estimates in the near term.

Valuations (consolidated) Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenue	19,779	21,052	19,429	26,129	29,340
OPM (%)	11.0	11.8	7.5	12.8	13.3
Adjusted PAT	1,519	1,519	786	2,131	2,519
% Y-o-Y growth	35.1	0.0	-48.2	171.0	18.3
Adjusted EPS (Rs.)	17.1	17.0	8.9	24.0	28.4
P/E (x)	71.4	71.6	137.5	50.7	42.9
P/B (x)	17.8	16.2	15.1	12.4	10.1
EV/EBIDTA (x)	49.4	44.1	74.5	32.4	27.5
RoNW (%)	27.2	23.8	11.4	26.8	25.8
RoCE (%)	37.2	30.6	13.6	31.5	32.3

Source: Company; Sharekhan estimates

Consolidated performance - Revenue declined by ~2%, ineffective hedges affected the profitability

In Q2FY2021, Titan's consolidated revenue declined by 2.3% y-o-y to Rs. 4,553 crore as jewellery business saw substantial recovery registering growth of 9% during the quarter.Revenue included sale of bullion of Rs.391 crore done to reduce inventory given the low level of sales.. The watches and eyewear businesses saw recovery of 55%-60%. Gross margin (excluding the bullion sales) declined by 470 bps to 24.1% due to unfavourable revenue mix (lower studded ratio) and higher gold prices. OPM declined by 433 bps to 6.9% as against our expectation of 7.5%. During the quarter, the company has recognised loss of Rs. 484 crore against cash flow hedging, which affected OPM substantially; Q1FY2021 was Rs. 205 crore.Moreover, there was the provision of Rs. 34 crore towards overdue margin money from a broker affecting profitability. Operating profit decreased by 40% to Rs. 313 crore and adjusted PAT decreased by 45% to Rs. 175 crore.

Jewellery business - Posted resilient performance in tough time

Revenue of the jewellery business grew by ~9% to Rs. 3,837 crore with gradual opening of stores and improvement in footfalls (with conversion rate and ticket size higher compared to the previous year).The company sold Rs. 391 crore of bullion as part of working capital optimisation. Excluding that sales would have decreased by ~2% y-o-y. The studded segment contribution improved to 26% from 18% in Q1 but still remains lower compared to the previous year's contribution of 38%. On the other hand, coin sales share grew to 14% in Q2FY2021 from 3% in Q2FY2020, which had impact on the revenue mix and gross margin of the jewellery business. Demand for gold coins might remain high as consumer feel safety is likely to invest in gold in the current uncertain environment. The enrolment in Golden Harvest Scheme is gathering momentum, which reached 85% of pre-covid level registrations. To reduce store traffic during the key days of the festive season, the company started promotional offering with few days prior to start of the festive season. Eleven days of Navaratri saw high single-digit growth in the jewellery sales, while wedding sales continue to see good momentum. EBIT margin of the jewellery business stood at 7.4% in Q2FY2021 as against 10.9% in QFY2020. However, adjusting for provisions made of Rs. 34 crore towards overdue margin money from broker, EBIT margin would have been 8.3% during the quarter. The company is planning to set up its own subsidiary, Titan Commodity, to avoid any such issues in the near future. Ineffective hedge losses continued due to mismatches in hedge designations and actual sale. Sale was higher-than-revised estimates and deferral of gold on loan repayments compounded the issue of ineffective hedge. The ineffective hedge loss during the quarter stood at Rs. 484 crore. Once business normalises, the company is confident of recovery in the jewellery business margin to 11%-12% in the coming quarters.

Watches business – Recovered to 55%

Revenue of the watches business recovered to 55% in Q2. However, the recovery rate was much higher at 70% in September. Trade channels pose challenge due to de-stocking, while strong growth was seen on the e-commerce platform. The business reported EBIT loss of Rs. 4 crore in Q2FY2021 as against loss of Rs. 164 crore in Q1FY2021 due to stringent cost focus. New product launches such as Titan Pay (in collaboration with top public sector bank) and Titan Connected X got good response in the domestic market. Management is confident of sales recovering to 70%-75% in Q3FY2021 with uptick in demand during the festive season.

Eyewear business – Strong improvement in profitability

Revenue of the eyewear business declined by 39% y-o-y to Rs. 94 crore. The business recovered to 70% in September 2020. The highlight of the quarter was business posted EBIT of Rs. 9crore at recovery of 61%. This was mainly on account of better product mix, lower discounts compared to last year, and stringent cost-control major. Management expects the business to recover to 70% in Q3FY2021 and expects sustained improvement in profitability.

Subsidiary continues to perform well

- Titan Engineering and Automation Limited (TEAL), which is a 100% owned subsidiary, registered strong performance with revenue decliningby just 14% y-o-y to Rs. 90 crore.The automation business segment continued to do well in Q2 as it has customers across diverse industries that seek automation solutions in their manufacturing facilities. The segment also received bigger repeat orders for supplying components for ventilators and medical devices capable of detecting TB and Covid-19. The aerospace business is, however, expected to get hit due to the demand situation. The business registered EBIT of Rs. 18 crore in Q2FY2021 as against Rs. 16 crore in Q2FY2020.

- Caratlane (72.3% owned subsidiary) posted strong recovery in Q2 with revenue growth of 10%. Growth was driven by continued high demand in the online channel as well as a sequential improvement in the revenue of stores, many more of which were able to open during the course of the quarter as lockdown restrictions were lifted.The business registered a profit of Rs. 1crore at EBIT level in Q2FY2021 as against loss of Rs. 4 crore in Q2FY2020.

Key highlights of the conference call

- **Jewellery demand see good recovery:** Eight of the 12 top cities (excluding Mumbai andPune) have seen recovery in jewellery sales to more than 80%. Tier II and tier III towns are seeing good demand. The festive season started on a good note and is expected to maintain the momentum throughout the quarter. The contribution of studded jewellery is expected to improve in the coming quarters with sales in top cities picking up. Wedding jewellery is seeing good demand and is expected to sustain in the near term.
- **Share gain from small players:** Local jewelers are under great pressure, while standalone jewelers managed to recover to 50%-55% of pre-covid levels. This helped the company to gain market share in most key markets.
- **Watches segment to recover to pre-covid level by Q4:** With cases coming down,management expects out-of-home consumption categories to see good demand. Thus,management expects the watches segment to recover to 100% by Q4FY2021 along with good improvement in profitability.

Result Snapshot (Consolidated) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Total Revenue	4553.0	4661.6	-2.3	1979.0	-
Raw material cost	3132.0	3274.9	-4.4	1545.0	-
Employee cost	248.0	305.1	-18.7	260.0	-
Advertising	61.0	142.8	-57.3	21.0	-
Other expenses	799.0	416.5	91.8	406.0	-
Total operating cost	4240.0	4139.3	2.4	2232.0	-
Operating profit	313.0	522.3	-40.1	-253.0	-
Other income	48.0	31.8	51.2	41.0	-
Interest & other financial cost	49.0	44.9	9.2	52.0	-
Depreciation	94.0	82.2	14.4	93.0	-
Profit Before Tax	218.0	427.0	-48.9	-357.0	-
Tax	44.0	112.7	-61.0	-64.0	-
Adjusted PAT before MI	174.0	314.3	-44.6	-293.0	-
Extraordinary item	0.0	0.0	-	0.0	-
Minority Interest (MI)	-1.0	-2.6	-	-4.0	-
Reported PAT	173.0	311.7	-44.5	-297.0	-
Adjusted EPS (Rs.)	2.0	3.5	-44.6	-3.3	-
			Bps		**Bps**
GPM (%)	31.2	29.7	146	21.9	-
OPM (%)	6.9	11.2	-433	-12.8	-

Source: Company; Sharekhan Research

Result Snapshot (Standalone) Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)	Q1FY21	q-o-q (%)
Total Revenue	4318.0	4435.0	-2.6	1862.0	131.9
Operating profit	294.0	513.2	-42.7	-246.0	-219.5
Reported PAT	199.0	320.2	-37.8	-270.0	-173.7
			Bps		**Bps**
GPM (%)	30.8	29.2	158	20.6	1020
OPM (%)	6.8	11.6	-476	-13.2	2002

Source: Company; Sharekhan Research

Segmental and subsidiaries revenue Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)
Watches	400	719	-44.4
Jewellery (including bullion sales)	3837	3528	8.8
Eyewear	94	154	-39.0
Others/Corporate	59	65	-9.2
Standalone	**4390**	**4466**	**-1.7**
Caratlane	**150**	**136**	**10.3**
TEAL	90	104	-13.5
Others/Consol. Adj	-28	-13	115.4
Consolidated	**4602**	**4693**	**-1.9**

Source: Company; Sharekhan Research

Segmental and subsidiaries EBIT Rs cr

Particulars	Q2FY21	Q2FY20	y-o-y (%)
Watches	-4	113	-
Jewellery	285	384	-25.8
Eyewear	9	2	-
Others/Corporate	-8	-29	-72.4
Standalone	**282**	**470**	**-40.0**
Caratlane	1	-4	-
TEAL	18	16	12.5
Others/Consol. Adj	-34	-13	-
Consolidated	**267**	**469**	**-43.1**

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – Discretionary consumption

Stores of retail and jewellery companies are opening up in most cities post the easing of lockdown norms, resulting in gradual recovery in revenue for most companies. With inter-city travel resuming and increased out-of-home consumption products (such as apparels and watches), footwear companies will also post strong recovery in Q3. With malls reopening and better festive/wedding demand, we will see apparel/jewellery companies performing better in H2FY2021. A full recovery of branded apparel, jewellery, and retail companies is expected by Q4FY2021. Profitability would be severely impacted in FY2021, while we expect it to come back on track in FY2022 (with strong recovery in sales). However, the sector's long-term growth prospects are intact as companies focus on expanding their reach (by targeting tier-II and-III towns),banking on e-commerce/online channels to drive the next league of growth, improving store fundamentals, and driving efficiencies to see better margins.

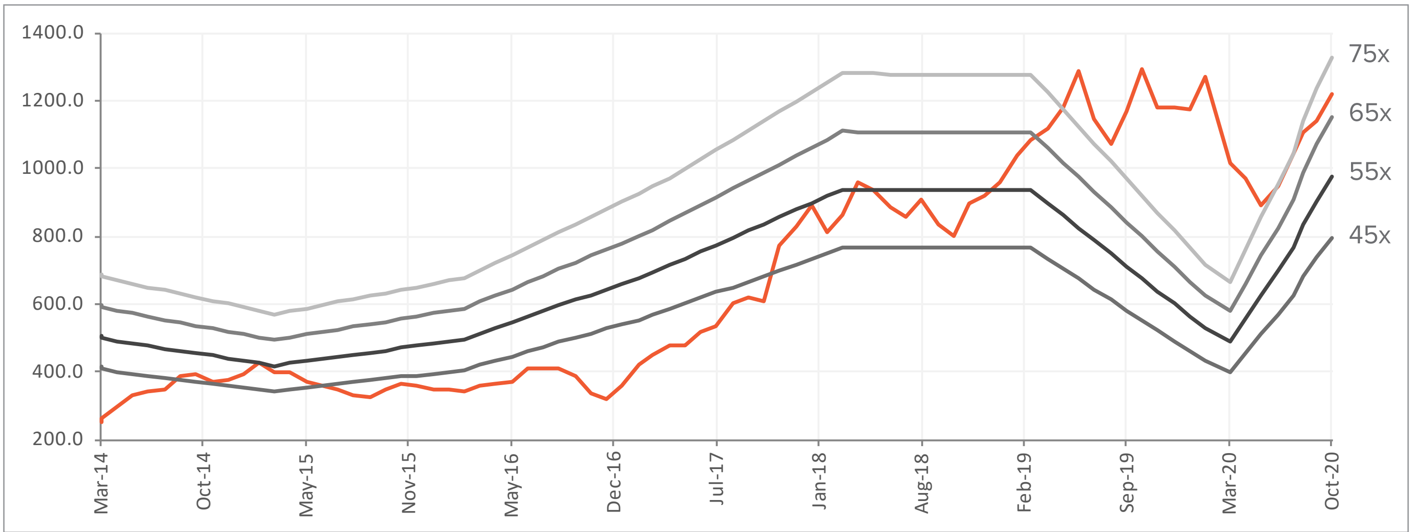
■ Company Outlook – Strong recovery anticipated in FY2022

Market share gains from small jewelers and higher festive/wedding demand would help Titan's Jewellery business to post good performance in the coming quarters. The watches and eyewear division has seen sequential improvement and would continue to benefit from higher sales through the online platform. Thus, full recovery in all the key businesses is expected by Q4FY2021. Further, with strong recovery anticipated in FY2022, consolidated OPM is expected to come back on track in FY2022.

■ Valuation – Retained Buy with a revised PT of Rs. 1,350

We have fine-tuned our estimates for FY2021 to factor in lower-than-expected OPM, while we have maintained our estimates for FY2022/FY2023E.Titan posted good recovery in Q2FY2021 with 97% of business recovering to pre-covid levels. Overall, we expect Titan to benefit from people shifting to trusted brands and market share gains. This, along with a relatively stable balance sheet, makes the company a better play in the retail space. We have a Buy recommendation on the stock with a revised PT of Rs. 1,350. The stock is currently trading at 50.7x and 42.9x its FY2022/FY2023E EPS (EV/EBIDTA of 32.4x/27.5x for FY2022/FY2023E).

One-year forward PE band



Source: Sharekhan Research

Peer Comparison

Particulars	P/E (x)			EV/EBIDTA (x)			RoCE (%)		
	FY20	FY21E	FY22E	FY20	FY21E	FY22E	FY20	FY21E	FY22E
Trent	-	-	-	36.1	49.1	31.9	13.8	5.6	9.7
Titan Company	71.6	137.5	50.7	44.1	74.5	32.4	30.6	13.6	31.5

Source: Company, Sharekhan estimates

About company

Titan is a joint venture between Tata Group and Tamil Nadu Industrial Development Corporation (TIDCO). The company is a leading organised jeweller in India with its trusted brand Tanishq. The company started as a watch company under the brand Titan and is the fifth-largest integrated own brand watch manufacturer in the world. The company's key watch brands are Titan, Fastrack, and Sonata. The company is present in the eyewear segment with its brand,TitanEyeplus, and in other segments such as perfumes. The company recently entered the saree market with its brand Taneira. Titan has a retail chain of 1,829 stores across India with a retail area crossing 2.4 million sq. ft. nationally for all its brands.

Investment theme

Titan is one of India's top retailers with a strong presence in discretionary product categories such as jewellery, watches, and eyewear. The company is one of the top brands in the watches segment; while in the jewellery space, it is gaining good acceptance because of the shift from non-branded to the branded space and expansion in middle income towns. The company endeavours to grow by 2.5x by FY2023 in its jewellery business. Recovery is likely in the jewellery business by Q3FY2021 whereas eyewear and watches businesses will see full recovery by Q4FY2021 with gradual improvement in the discretionary demand.

Key Risks

- **Increased gold prices:** Any increase in gold prices would affect profitability of the jewellery segment and earnings growth of the company.
- **Slowdown in discretionary consumption:** Any slowdown in discretionary consumption would act as a key risk to demand of the jewellery and watches division.
- **Increased competition in highly penetrated categories:** Increased competition in the highly penetrated categories such as watches or jewellery would act as a threat to revenue growth.

Additional Data

Key management personnel

C K Venkataraman	Managing Director
N Muruganandam	Chairman
N N Tata	Vice Chairman
S Subramaniam	Chief Financial Officer
Dinesh Shetty	Company Secretary

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Republic of India	28.2
2	Jhunjhunwala Rakesh	4.4
3	Life Insurance Corporation of India	2.5
4	BlackRock Inc	1.3
5	Vanguard Group Inc	1.3
6	SBI Funds Management Pvt Ltd	1.2
7	Jhunjhunwala Rekha Rakesh	1.1
8	Matthews International Capital Management	1.1
9	UTI Asset Management Co Ltd	0.7
10	ICICI Prudential Asset Management Co Ltd	0.7

Source: Bloomberg As on August 10, 2020

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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