Tata Motors

Estimate Change **NEUTRAL**

Equity | India | Autos/Car Manufacturers
26 April 2007

Merrill Lynch

Cars to further restrict growth

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Weak H1 not fully factored

We are lowering forecasts, as we believe that intensifying competition will restrict growth in passenger vehicles. We maintain our negative stance on trucks in fiscal 2008, but remain positive on light vehicles over the medium term. We believe that the impact of slower growth will be reflected in H1 financial performance, and has yet to be fully factored by the markets. We therefore maintain our Neutral rating.

We are revising down forecasts

We are lowering EPS estimates by ~4% for each of the next 2 years, to factor expectations of slower growth in passenger cars. We are leaving other segment volume assumptions i.e. trucks and light vehicles largely unchanged. We expect EPS CAGR of 12.4% over FY07-09E (lower than the 14.2% CAGR estimated earlier).

Slowdown in trucks to be felt most in H1 FY08

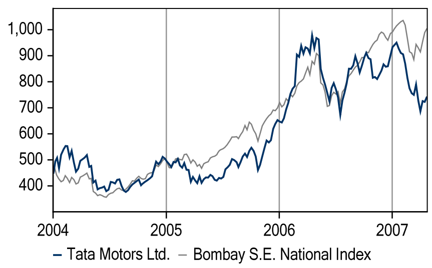
We expect a 1.5% YoY contraction in FY08 sales, but a rebound of 12.8% in FY09. Also, we expect contraction in truck demand for fiscal 2008 to be front ended, without the benefit of overloading led demand last year.

Imputed value offers limited upside; Maintain Neutral

We estimate theoretical fair value at Rs 784, which is based on 6x EV/EBITDA FY09E, which reflects the average of historic 1-year forward multiple. The value of investments (mainly Tata Sons and Tata Steel) will add Rs 79/share. We believe that these investments will not be monetized.

Stock Data

Price (Common / ADR)	Rs758.80 / US$18.81
Investment Opinion	C-2-7 / C-2-7
Volatility Risk	HIGH / HIGH
52-Week Range	Rs650.50-Rs997.00
Market Value (mn)	US$7,418
Shares Outstanding (mn)	402.5 / 402.5
Average Daily Volume	400,996
ML Symbol / Exchange	TENJF / BSE
ML Symbol / Exchange	TTM / NYS
Bloomberg / Reuters	TTMT IN / TAMO.BO
ROE (2007E)	32.0%
Net Dbt to Eqty (Mar-2006A)	31.6%
Est. 5-Yr EPS / DPS Growth	20.0% / 20.0%
Free Float	68.0%



Estimates (Mar)

(Rs)	2005A	2006A	2007E	2008E	2009E
Net Income (Adjusted - mn)	13,939	16,139	22,215	23,852	28,088
EPS	38.53	42.15	55.19	59.26	69.78
EPS Change (YoY)	49.5%	9.4%	30.9%	7.4%	17.8%
Dividend / Share	12.50	13.00	14.00	15.00	17.50
Free Cash Flow / Share	14.30	(73.50)	18.31	0.830	16.86
ADR EPS (US$)	0.859	0.953	1.27	1.44	1.69
ADR Dividend / Share (US$)	0.279	0.294	0.340	0.364	0.425

Valuation (Mar)

	2005A	2006A	2007E	2008E	2009E
P/E	19.69x	18.00x	13.75x	12.81x	10.87x
Dividend Yield	1.65%	1.71%	1.85%	1.98%	2.31%
EV / EBITDA*	12.64x	10.33x	7.79x	7.09x	5.90x
Free Cash Flow Yield*	1.69%	-9.21%	2.41%	0.109%	2.22%

* For full definitions of ***iQmethod*** SM measures, see page 10.

iQprofile SM Tata Motors

Key Income Statement Data (Mar)	2005A	2006A	2007E	2008E	2009E
(Rs Millions)					
Sales	195,328	237,182	323,023	366,941	440,202
Gross Profit	24,966	30,539	40,508	44,526	53,532
Sell General & Admin Expense	NA	NA	NA	NA	NA
Operating Profit	18,955	23,588	32,359	34,236	40,995
Net Interest & Other Income	(357)	(1,668)	(1,688)	(1,051)	(1,701)
Associates	0	0	0	0	0
Pretax Income	18,598	21,921	30,671	33,185	39,294
Tax (expense) / Benefit	(4,906)	(6,400)	(8,498)	(9,027)	(10,690)
Net Income (Adjusted)	13,939	16,139	22,215	23,852	28,088
Average Fully Diluted Shares Outstanding	362	383	403	403	403
Key Cash Flow Statement Data					
Net Income (Reported)	13,971	15,712	22,100	23,852	28,088
Depreciation & Amortization	6,011	6,951	8,149	10,290	12,536
Change in Working Capital	(4,555)	(29,349)	4,041	(3,040)	(1,190)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	13	1,647	67	100	100
Cash Flow from Operations	15,440	(5,040)	34,357	31,203	39,534
Capital Expenditure	(10,267)	(23,103)	(26,989)	(30,868)	(32,749)
(Acquisition) / Disposal of Investments	2,274	8,649	(4,687)	(5,000)	(5,000)
Other Cash Inflow / (Outflow)	NA	NA	NA	NA	NA
Cash Flow from Investing	(7,993)	(14,454)	(31,676)	(35,868)	(37,749)
Shares Issue / (Repurchase)	50	211	196	0	0
Cost of Dividends Paid	(5,219)	(5,844)	(6,614)	(7,086)	(8,267)
Cash Flow from Financing	3,852	12,385	(5,694)	7,739	(5,605)
Free Cash Flow	5,173	(28,143)	7,369	334	6,785
Net Debt	6,169	19,927	22,275	32,451	37,021
Change in Net Debt	(1,141)	13,758	2,348	10,177	4,570
Key Balance Sheet Data					
Property, Plant & Equipment	45,816	54,359	73,199	93,777	113,989
Other Non-Current Assets	21,780	16,737	21,424	26,424	31,424
Trade Receivables	12,414	13,537	19,470	23,122	28,945
Cash & Equivalents	20,973	13,864	10,851	13,925	10,105
Other Current Assets	49,020	84,900	95,331	108,649	125,585
Total Assets	150,003	183,398	220,275	265,897	310,048
Long-Term Debt	27,142	33,791	33,126	46,376	47,126
Other Non-Current Liabilities	6,205	6,768	7,583	8,352	9,248
Short-Term Debt	NA	NA	NA	NA	NA
Other Current Liabilities	72,270	79,924	100,329	114,259	135,827
Total Liabilities	105,617	120,483	141,037	168,988	192,201
Total Equity	44,602	63,054	79,731	97,303	118,140
Total Equity & Liabilities	150,220	183,537	220,769	266,291	310,341
iQmethod **SM - Bus Performance***					
Return On Capital Employed	20.7%	18.7%	21.1%	18.5%	18.4%
Return On Equity	34.6%	30.7%	32.0%	27.8%	27.0%
Operating Margin	9.7%	9.9%	10.0%	9.3%	9.3%
EBITDA Margin	12.8%	12.9%	12.5%	12.1%	12.2%
iQmethod **SM - Quality of Earnings***					
Cash Realization Ratio	1.1x	-0.3x	1.5x	1.3x	1.4x
Asset Replacement Ratio	1.9x	3.7x	3.7x	3.4x	3.0x
Tax Rate (Reported)	26.4%	29.2%	27.7%	27.2%	27.2%
Net Debt-to-Equity Ratio	13.8%	31.6%	27.9%	33.4%	31.3%
Interest Cover	11.2x	9.6x	9.7x	8.4x	8.7x
Key Metrics					

* For full definitions of *iQmethod* SM measures, see page 10.

Company Description

Tata Motors (est. 1945) is India's leading automobile maker, and is among the top 10 auto manufacturers in the world. The company has more than 130 models spanning a wide range of commercial vehicles, passenger cars and multi-utility vehicles. The company operates out of plants at Jamshedpur, Pune and Lucknow. Key export markets include Europe, Australia, South East Asia, the Middle East and Africa.

Stock Data

Shares / ADR	1.00
Price to Book Value	3.9x

Forecasts revisited

We are lowering forecasts on expectations of lower growth in passenger cars, and further pressure on margins. Based on revised estimates, we expect EPS CAGR of 12.4% over FY07-09 (earlier 14.2% CAGR).

Growth to slow due to lower volumes, decline in margins

We expect EPS CAGR of 12.4% over FY07-09E (lower than the 14.2% CAGR estimated earlier). We have largely left our negative stance on trucks (decline of 1.5% in FY08 and 12.8% growth in FY09), and positive view on light vehicles (growth of 24.1% and 26% respectively), unchanged. The lowering of earnings estimates, therefore, is on the back of:

1. Weaker passenger car growth expected in FY08, on the back of bunching of products from competition. We now expect a much slower 6.6% sales growth in FY08 (earlier 12.4%), with a rebound expected towards the end of FY09 due to the launch of small car;

2. Faster margin compression due to shift in sales mix from trucks to relatively less profitable segments. We expect 60bps cumulative decline in standalone margins over the next 2 years;

Table 1: Volume assumptions

	Volume (nos)			YoY (%)		
Domestic	FY07	FY08E	FY09E	FY07	FY08E	FY09E
Trucks	159,138	156,683	176,672	37.2%	-1.5%	12.8%
Buses	12,658	14,557	17,468	21.4%	15.0%	20.0%
Light CVs	126,885	157,419	198,360	43.3%	24.1%	26.0%
Cars	179,216	191,120	261,910	18.8%	6.6%	37.0%
Utility Vehicles	47,893	53,148	58,779	26.4%	11.0%	10.6%
Total	525,791	572,927	713,189	30.3%	9.0%	24.5%
Exports	53,231	61,854	70,772	5.4%	16.2%	14.4%
Total	579,022	634,781	783,961	27.5%	9.6%	23.5%

Source: Merrill Lynch Research Estimates

Table 2: Revision of estimates

	Earlier			Revised			Revision		
Stand-alone (Rsbn)	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E	FY07E	FY08E	FY09E
Net Sales	274.0	305.3	365.9	275.2	305.0	366.1	0.5%	-0.1%	0.0%
EBITDA	33.3	36.8	43.8	33.6	35.7	42.5	0.8%	-3.0%	-2.9%
Margin	*12.2%*	*12.0%*	*12.0%*	*12.2%*	*11.7%*	*11.6%*	4bps	-35bps	-36bps
PAT	18.8	19.9	23.6	19.1	19.4	22.6	1.4%	-2.5%	-4.4%
EPS (Rs)	46.8	49.4	58.7	47.4	48.2	56.1	1.4%	-2.5%	-4.4%
Consolidated EPS (Rs)	56.0	62.0	73.0	55.2	59.3	69.8	-1.4%	-4.4%	-4.4%

Source: Merrill Lynch Research Estimates

Impact will be reflected in H1 FY08

The positive impact of overloading ban was largely reflected in Tata Motors' heady growth rates last year, especially in the initial half. As a result, we expect YoY sharply lower growth rates in H1 FY08, thereby impacting earnings. We expect back ended recovery in fiscal 2008.

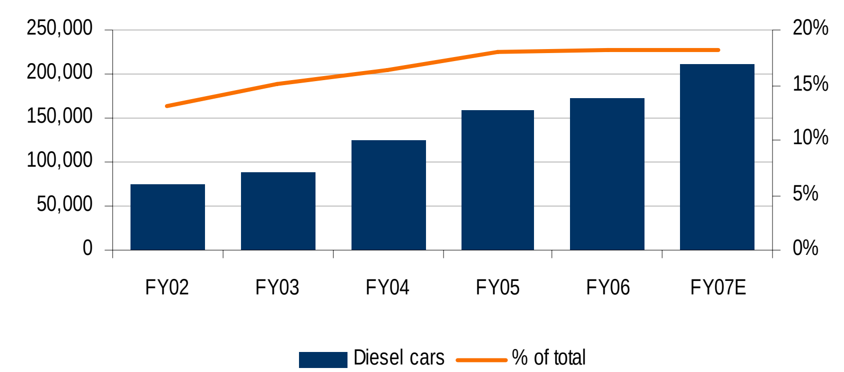
Bullish on Cars, but Tata Motors vulnerable

We expect mid-teens growth in passenger cars, led by diesel. However, we expect Tata Motors to be the biggest loser, as several competitive launches are expected to hit the roads this year. We expect the company's growth rates to slip to single digits in FY08.

Diesel market to expand

The domestic diesel space accounts for ~18% of passenger cars sold. Over the past 5 years, the segment has outgrown the petrol version, driven by the superior operating cost advantage. With improving technology, we expect the proportion of diesel cars to increase significantly from present levels.

Chart 1: Diesel market has consistently gained share



Source: Merrill Lynch Research Estimates

Tata Motors' dominance likely to get eroded

Tata Motors' share is estimated at 78%. While Maruti launched *Swift* Diesel towards the end of FY07E, M&M launched *Logan* with a similar option in April this year. Hyundai is also expected to make foray with *Getz* diesel. With key competitors expected to roll out diesel passenger cars, mostly in the compact and entry level mid-sized segment, we believe that Tata Motors will be most vulnerable to slowing growth.

Upgrades, new platform only by FY09

The popular compact *Indica V2* witnessed another facelift last year, and the mid-sized sedan *Indigo* is now available in both the Dicor (common rail injection) and extended versions. However, a brand new platform will be introduced only over the next 12-18 months, as Maruti and Hyundai will be ready with directly competing products much earlier. Also, the company's association with Fiat will start yielding results only after 2-3 years.

Small car impact in subsequent years

With the land acquisition controversy behind, the Rs 1mn car will likely roll out early CY09. While markets are skeptical about the success of this launch, we are quite optimistic. We believe that customers are looking to upgrade from two wheelers, which have hardly seen any significant innovation over the past 2 decades (except the launch of premium segment). We believe that a ready customer base will take to the small car, provided it meets the basic requirements of style and cost efficiency.

Truck demand to decelerate sharply

We reiterate our early call of demand to contract by 1.5% YoY in fiscal 2008, with recovery only towards the latter half of the year. We expect Tata Motors' share to decline, especially with its unwieldy share in the declining 16 T segment.

Reiterate weak outlook for fiscal 2008

We expect truck demand to contract 1.5% in FY08, restricted by the absence of overloading impact. Continuing shift to higher tonnage vehicles is expected to limit volume sales. We expect YoY recovery only towards the end of the year. FY09 will likely register ~13% growth, driven by a sustained rise in freight availability.

We expect Tata Motors' share to decline

Tata Motors' share has stabilized ~65%, despite declining trends in the 16T rigid segment (where it commands an unwieldy 76.7% share). In fast moving multi-axles, competition is equally well placed in the off-highway applications category. In tractor-trailers, which are vehicles for the future, Tata Motors has fared well, thanks to cost-competitive products. Going ahead, we expect Tata Motors' share to be capped, given a slew of entrants in high-end product categories.

Table 3: Tractor trailer gains offset competitive pressures

	% share	Tata Motors' share (%)		
	FY07	FY05	FY06	FY07
Medium CVs	10.7%	37.8%	42.8%	47.1%
Heavy CVs (16 T Rigid)	30.7%	81.8%	78.4%	76.7%
Multi-axle vehicles (25 T)	46.5%	65.9%	64.6%	62.7%
Haulage Tractor Trailers	12.1%	51.8%	53.1%	67.3%
MHCV	100.0%	67.1%	64.8%	64.6%

Source: Merrill Lynch Research, Society of Indian Automobile Manufacturers

Light vehicles should continue to do well

We expect the segment to deliver strong growth rates, on the back of multiple intra-city applications. Although Tata Motors will likely face competition, we still expect the franchise of Ace to carry through 20%-plus annual growth.

Growth rates have accelerated

Light vehicles registered double-digit growth over the past decade, accelerating to 26.6% CAGR over the past 2 years. We expect demand to remain robust, driven by 1 T carriers, which finds usage in multiple intra-city applications.

Sub-3.5 T segment is driving growth

Over the past few years, demand for light vehicles has structurally moved to down to 'sub-3.5 T' goods carriers, which has grown significantly ahead of other segments. Larger light vehicles are steadily losing ground, as are three-wheelers.

Table 4: 1 T carriers gaining at the expense of other segments

	FY05	FY06	FY07	CAGR FY05-07
LCVs (<3.5T)	54,909	81,794	132,067	55.1%
LCVs (3.5-7.5T)	45,031	40,034	36,436	-10.0%
Three-Wheelers	136,898	147,441	167,121	10.5%

Source: Merrill Lynch Research, Society of Indian Automobile Manufacturers

Tata Motors' share near peak levels

Tata Motors' aggregate share has grown to over 65% (up from ~50%, 2 years ago), thanks to the hugely successful *Ace*. Piaggio's 1 T carrier *Quargo* will hit the roads later this month. Going by Piaggio's exceptional record in three wheeler cargo carriers, we believe that this will restrict the heady growth rates of Tata Motors. Other auto majors too have indicated intention to enter this segment as well e.g. Bajaj Auto, M&M, Hyundai etc, which will inevitably pull down Tata Motors' market share.

Table 5: Tata Motors' heady growth rates will slow

	% share	Market Share (%)		
	FY07	FY05	FY06	FY07
LCV <3.5T	72.0%	38.1%	59.9%	68.6%
LCV 3.5-7.5T	18.5%	68.1%	68.1%	63.9%
Buses	9.5%	46.0%	49.1%	50.0%
LCV	100.0%	50.7%	60.5%	65.4%

Source: Merrill Lynch Research, Society of Indian Automobile Manufacturers

Entry in 6-seater passenger market a positive

Tata Motors' upcoming facility in a tax-free area is expected to roll out the passenger version of *Ace*. We believe that this product will compete with small-sized three wheelers, and more directly, to existing 6-seater passenger vehicles not meant for personalized use. Last year, ~85,000 units of such vehicles were sold. Also, just as the *Ace* achieved in the cargo segment, we expect Tata Motors to be able to expand this space.

Table 6: Sizeable addressable market for Tata Motors' proposed segment

	FY02	FY03	FY04	FY05	FY06	FY07	CAGR FY05-07
Three wheelers	158,256	164,473	169,101	171,383	212,746	236,787	17.5%
Utility Vehicles <7 seats	18,678	23,886	30,504	47,645	66,964	84,579	33.2%
Small passenger carriers	176,934	188,359	199,605	219,028	279,710	321,366	21.1%
		6.5%	6.0%	9.7%	27.7%	14.9%	

Source: Merrill Lynch Research, Society of Indian Automobile Manufacturers

Small buses will continue steady pace of growth

Steady growth in this segment has offset mixed fortunes of the cargo business. Usage is driven by demand from niche applications e.g. executive transport for corporate use, ambulances, fire engines etc. We expect growth rates to remain steady at 5-10% annually.

Exports offer long term opportunity

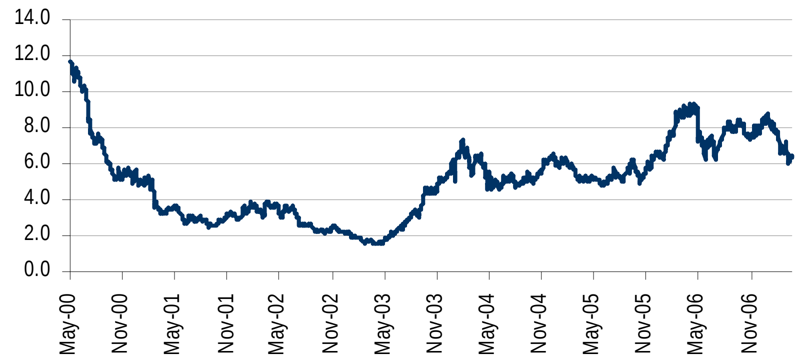
Tata Motors' success in Africa is measured not just by the sizeable units sold, but also the presence of significant global competition (Nissan, Toyota, Isuzu, Iveco). Consequently, Tata Motors is looking at key markets such as Thailand, Latin America and the Far East to enhance volumes.

Valuations reasonable, yet limited upside

Maintain EV/EBITDA as key valuation parameter

We maintain EV/EBITDA as the primary valuation tool for Tata Motors, as this captures cyclicality as well as the investment cycle more appropriately. The stock has historically traded in a wide EV/EBITDA band, with a benchmark average of 6x 1-year forward multiple.

Chart 2: EV/EBITDA band



Source: Merrill Lynch Research Estimates

Expect stock to trade at average of trading band

We believe that the stock should continue to trade in the average of 6x EV/EBITDA. We expect the company's diversified product profile, sizeable scale and solid distribution will enable maintain dominant market share in the future. Competition from new entrants as well as railways will likely impact smaller players, much before affecting Tata Motors.

Sum of parts value Rs 784

Based on 6x EV/EBITDA FY09E, we arrive at our sum of parts value of Rs 784. We have imputed a 25% holding company discount to unlisted subsidiaries. Based on fair value, which seems a realistic case, stock upside is limited to 3%. We have also worked out other extreme scenarios, differentiated by imputed multiples. In the optimistic case, value of investments (Tata Sons and Tata Steel) has also been factored in. These, in our opinion, are unlikely to be monetized.

Table 7: Sum of parts valuation

FY09E (Rsmn)	Methodology	Imputed Multiple	EBITDA	Net Profit	Mcap	Value/Share Rs
Standalone	EV/EBITDA	6.0	42,130		253,089	629
Subsidiaries						207
- Tata Daewoo	EV/EBITDA	6.0	1,725		11,771	29
- HV Axles	EV/EBITDA	6.0	1,038		5,819	14
- HV Transmission	EV/EBITDA	6.0	836		3,673	9
- Telcon (60%)	P/E	15.0		2,262	20,354	51
- TACO (50%)	P/E	15.0		2,936	22,017	55
- Tata Technologies (86.9%)	P/E	15.0		742	11,130	28
- Tata Finance*	P/ Adj NAV	1.5			8,550	21
Less: Holding co discount						52
Consolidated Value/Share						784

Source: Merrill Lynch Research Estimates *includes financing operations within Tata Motors

Table 8: Valuation scenarios

	Pessimistic	Realistic	Optimistic
EV/ EBITDA Multiple	5.5	6.0	6.5
Value per Share			
Standalone	576	629	688
Subsidiaries/Associates	203	207	211
Investments (Tata Sons/Tata Steel)	-	-	105
Less: Holding co discount (25%)	51	52	79
Consolidated Value/Share (Rs)	728	784	925

Source: Merrill Lynch Research

Maintain Neutral

On P/E, valuations seem reasonable at 12.8x FY08E and 10.9x FY09E EPS. We however believe that the risks of slower growth, especially in early fiscal 2008, are yet to be fully factored in. We therefore retain our Neutral rating on the stock.

Analyst Certification

I, S. Arun, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Special Disclosures

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iQmethod SM Measures Definitions

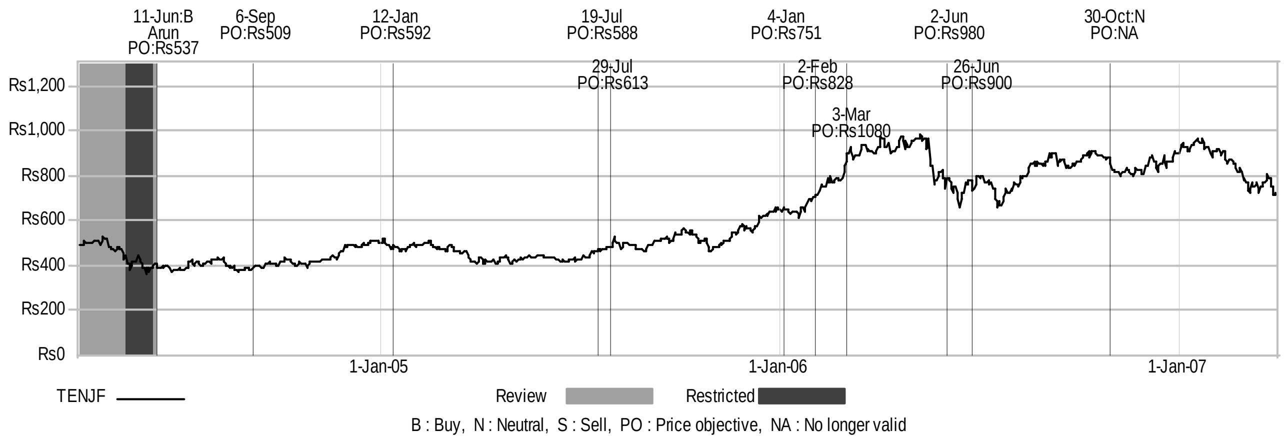
Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
Quality of Earnings		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
Valuation Toolkit		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

***iQ**method* SM is the set of Merrill Lynch standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and validations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

***iQ**database* ® is our real-time global research database that is sourced directly from our equity analysts' earnings models and includes forecasted as well as historical data for income statements, balance sheets, and cash flow statements for companies covered by Merrill Lynch.

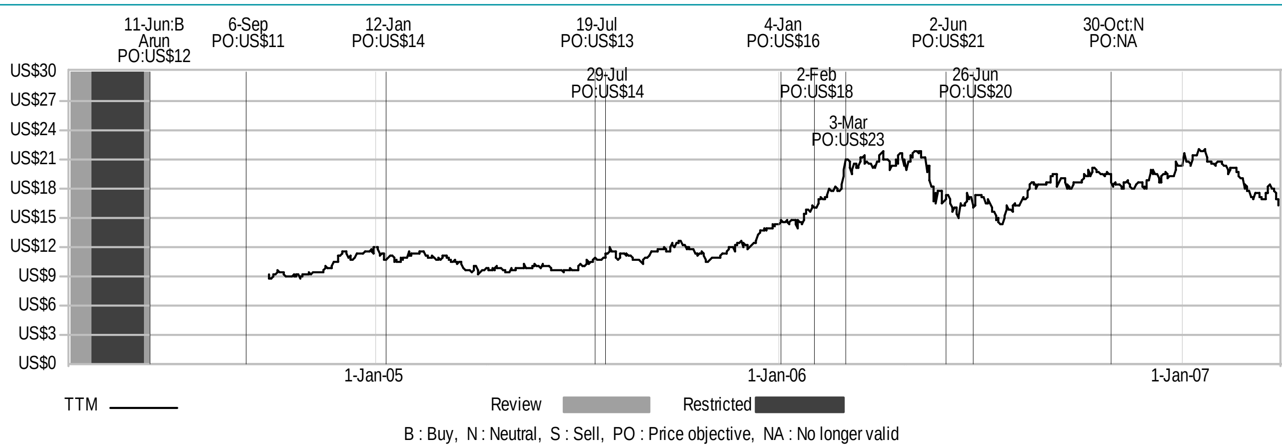
Important Disclosures

TENJF Price Chart



The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark Grey shading indicates the security is restricted with the opinion suspended. Light Grey shading indicates the security is under review with the opinion withdrawn. Chart current as of March 31, 2007 or such later date as indicated.

TTM Price Chart



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Investment Rating Distribution: Autos Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	39	41.94%	Buy	8	25.00%
Neutral	40	43.01%	Neutral	3	8.82%
Sell	14	15.05%	Sell	1	7.69%

Investment Rating Distribution: Global Group (as of 31 Mar 2007)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1562	45.16%	Buy	415	30.09%
Neutral	1615	46.69%	Neutral	446	30.65%
Sell	282	8.15%	Sell	49	19.76%

* Companies in respect of which MLPF&S or an affiliate has received compensation for investment banking services within the past 12 months.

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