

TATA MOTORS

INR 711

JLR – Is it money down the drain

BUY

Despite all signals (freight rates, interest rates, vendor production plans, and better sales trajectory since September) pointing towards a solid recovery in Q4 in Tata Motors' core truck business, the stock has remained flat since mid-November, ever since it emerged as the front runner for Jaguar-Land Rover (JLR).

On the other hand, the share price of Ashok Leyland (ALL), its biggest competitor in the CV space, has appreciated by ~25% in the same period. There have been rumours of expected corporate actions in ALL, but logic and recent developments seem to belie them. A share buyback, one of the rumours, does not make sense given ALL's INR 40 bn capex plan and the recent fund raising through ECB (USD 250 mn) to fund it. An alliance, JV or merger with a global truck maker is also highly unlikely, given AB Volvo and Daimler AG, the two most likely partners, have recently struck deals with Eicher and Hero group respectively.

This would imply that the market is looking at the ALL stock as a direct play on the anticipated recovery in the commercial vehicle cycle, and unlike Tata Motors', unburdened with the lingering uncertainty and baggage of a big global acquisition. Our analysis suggests the market is valuing JLR as worthless. We see an anomaly here and maintain our 'BUY' recommendation on the Tata Motors stock.

* **JLR – is it absolutely worthless?**

Assuming that the underperformance of Tata Motors stock is primarily or solely attributable to its ambitious bid for Jaguar and Land Rover – JLR - (everything else regarding its huge capex programme and new product launches already well-known and discounted), the market is currently valuing JLR as NEARLY COMPLETELY WORTHLESS and Tata Motors' USD 2 bn bid as so much money down the drain (based on the abovementioned 25% underperformance on Tata Motors' current market cap of USD 7 bn and EV of about USD 8 bn).

Even leaving aside the putative long-term strategic value of JLR to TAMO, is it really as worthless as implied by the market's recent reaction? Consider the following factoids:

- Total revenues of USD 12-13 bn.
- Sales volumes of 250,000-260,000 p.a. (Jaguar – 50,000; Land Rover – 200,000) with strong growth in emerging markets of China and Russia.
- Imminent launches of new models which have received rave reviews and could lay the foundation of a big turnaround.
- Average selling prices of ~USD 40,000 for Jaguar and USD 60,000 for Land Rover.
- Significant improvement in financial performance, with a small combined profit in Q3CY07 (source Ford's 10-Q filing).
- BMW and Porsche earn EBITDA margins of 15-20% with average selling prices of USD 50,000 and 100,000 respectively.
- Iconic brands, even considering the supposed "dilution" under Indian ownership.
- Proprietary technologies, especially for off-roading, such as the Terrain Response System of Land Rover.

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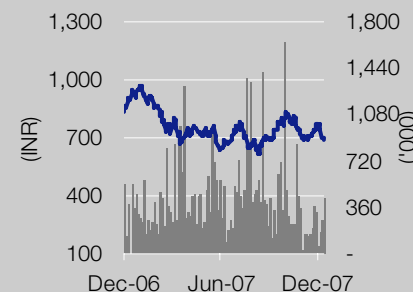
Reuters : TAMO.BO
Bloomberg : TTMT IN

Market Data

52-week range (INR) : 975 / 616
Share in issue (mn) : 385.5
M cap (INR bn/USD mn) : 274 / 6,925
Avg. Daily Vol. BSE/NSE ('000) : 1,730.2

Share Holding Pattern (%)

Promoters : 33.4
MFs, Fls & Banks : 16.4
Fls : 15.9
Others : 34.3



* Nature of the beast

By focusing on the recent troubles of JLR, the market is ignoring one of the basic tenets of the automobile business – given that volumes depend so much on a continuous stream of new products, all companies (irrespective of how strong their brands are) stumble once in a while when successive products launches fail. This is generally followed by a spate of successful products. Smart investors would spot the beginning of a turnaround and jump on it.

Witness Fiat – since February-2005, its stock has grown 3.3x from Euro 5 to Euro 17, outperforming even Toyota, following the launch of *Panda*, *Grande Punto* (to be launched in India in Q3FY09 through Tata Motors), *Bravo*, and *Linea*, and most recently the *Cinquecento* (500 in Italian). Or look at General Motors (GM); with the first products developed under its vice chairman and head of product development Bob Lutz, coming into the market now, it has got 4 out of 6 nominations for Car of the Year in the US in 2007.

Closer home, Maruti stumbled in 1999-2000 with the onslaught of *Santro*, *Matiz*, and *Indica* with only tired *M-800* and *Zen* to compete with. With the launch of *Alto* and *Wagon-R*, it recovered and has learnt its lesson going by the continuous stream of products coming out ever since.

Mr. Tata seems to have spotted that turnaround opportunity with JLR. Ford is desperate to be rid of them, the business is on the mend, and the price is reasonable. So why wouldn't he jump on it? Automobile investors don't flinch on hearing of big capex and investment plans, they revel in it.

* And what about its own product launches

And if product launches are so important, what is Tata Motors doing about its own tired line-up. A lot, it appears, without a doubt.

- A new compact car platform will be launched next month. We believe, it will get margins comparable to the rest of the industry (Maruti – 14%; Hyundai – 14-15%), unlike the current *Indica*, which despite its bigger size and bigger diesel engine sells at prices in line with smaller Maruti and Hyundai vehicles. What reaffirms our belief are the recent investments (acquisitions of INCAT, setting up of European Technical Centre) and strides made by the company in terms of building quality and refinement. One dealer recently told us he made his first sale of a Tata vehicle to his own family – a *Tata Safari DICOR VTT* to his mother-in-law confident that it will not give any trouble. Now that is as big a vote of confidence as you will get.
- The much awaited small car – whatever be the price point (1 lakh or 1.5 lakh), we believe it will be game changer.
 - Do-ability – after initial skepticism, even competitors are getting around to try and imitate it. Renault, the only company to actually have a low cost model - the Logan - in the market, is going after that price point with Bajaj Auto.
 - Viability – it is indeed a volume game, but the market is there. Whichever way one looks at it – *Alto*, at INR 250,000, sells around 200,000 p.a.; M-800 at INR 200,000 used to sell about 200,000 at its peak. So, any decent product at a 20-40% lower price point can get 300,000-400,000 volumes.
 - A decent product, did I hear – Those who have seen it have been raving about its looks and roominess. And to that add the quality and refinement angle mentioned above.

- Fiat alliance – To get a wider range of products in its showroom and world class technology, Fiat makes a perfect partner for Tata Motors. It is the king of compact cars, it has the fabled Italian design flair, and it has the powertrain technology. And it is on an upswing (see above). And it needs Tata Motors just as much as Tata Motors needs it. That makes a partnership of equals, the most successful sort.
- Trucking on – While we believe the car business is what will provide the big delta and positive surprise, Tata Motors is not taking its eyes off the ball there. The Daewoo acquisition was meant to provide a platform for its global foray in the truck market; and a slew of new launches in the domestic and international markets (world truck, new pick up) is slated for the next two years. And then there is the bus segment that is often ignored, but is a market waiting to explode. In this segment too, there is a whole new product range to be introduced in the next two years, through its JV with Marco Polo.

* What is the price

On our consolidated EPS estimate of INR 65 for FY09E (up 14% on FY08E) the stock is at 11x with RoE about 20%. This estimate does not factor in the small car. It does not factor in the new *Indica* (or whatever it may be called). It factors in a 10% growth in M&HCV over FY08E, 15% in LCV, and 12% for passenger vehicles. It also factors in a 40bps improvement in margins over FY08E and growth of 30% in the profits of its subsidiaries (FY08-YTD 100%). Not an aggressive number in anyway.

Our back-of-the-envelope calculations suggest that the acquisition may be nearly earnings neutral. The reported USD 2 bn acquisition price and assuming funding in the ratio of 1:1 imply equity dilution of about 15% (USD 1 bn on the current market cap of USD 7 bn) and additional debt of USD 1 bn, with attendant post-tax interest cost of about USD 50 mn (overseas debt used to fund overseas acquisition should not require any hedging). Further, assuming a small profit of USD 100 mn for JLR for FY09E (Ford's most recent 10-Q filing reports a small combined profit for JLR though exact figure is not reported), the acquisition would dilute Tata Motors' consolidated earnings by about 5.9%. This approach ignores any acquisition-related charges and also any post-acquisition funding required for capex. However, it also ignores any improvement in JLR's financial performance which has been on the mend in 2007, driven by strong volume growth, especially in China and Russia.

Table 1 – Tata Motors' FY09E earnings sensitivity to JLR acquisition

	JLR post tax earnings (USD mn)					
	-5.9%	50	100	150	200	250
Extent of debt funding	40%	-13.3%	-6.9%	-0.6%	5.7%	12.0%
	50%	-12.4%	-5.9%	0.6%	7.1%	13.5%
	60%	-11.4%	-4.8%	1.9%	8.5%	15.2%
	70%	-10.4%	-3.6%	3.2%	10.0%	16.8%
	80%	-9.4%	-2.4%	4.6%	11.6%	18.6%

Source:

Note: Based on Tata Motors' consolidated FY09E PAT of USD 675 mn; acquisition price of USD 2 bn; interest rate on debt of 7% and effective tax rate of 30%.

Source: Edelweiss research

* So...

So that is how it all ties up together. That is the whole elephant for you – not just the trunk or the tail or the ears – and it is not white. We suggest you hitch a ride now. We reiterate strong 'BUY' recommendation on the stock.

Company Description

Tata Motors is India's largest automobile company with a presence in commercial and passenger vehicles. It is the leader in nearly all commercial vehicle segments and second largest in the passenger vehicles market with products in the compact and midsize car as well as utility vehicle segments. The company is the world's fifth largest medium and heavy commercial vehicle manufacturer. Tata Motors is listed on the New York Stock Exchange (since September 2004). It derives about 10% of its revenues from exports. The company has plants in Jamshedpur, Pune, Lucknow and Dharwad, and R&D centers in Pune, Jamshedpur, Lucknow, in India, and South Korea, Spain, and the UK.

Investment Theme

Tata Motors is in a strong position to ride the growth seen in commercial vehicles due to increased industrial activity. For the company's passenger car business, the recent alliance with Fiat strengthens its position significantly from the standpoint of access to world-class technology and overseas market in a highly competitive environment. In addition, the company has significant potential for value unlocking from its investments in a variety of automotive and related businesses, such as auto components and automotive and engineering design, and financial services.

Key Risks

A slowdown in economic activity may affect CV sales significantly. Another key risk is the increasing competition in the passenger vehicle space, especially in diesel cars, and also in the compact segment. Also, increases in input prices could affect margins, as competition limits the company's ability to pass on cost hikes. The company plans to invest significant amount of money in new product launches. Non-acceptance of these products in the market could cause a substantial financial setback for the company.

Financial Statements

Income statement						(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E	
Total volume (nos)	399,561	454,345	578,805	642,244	721,108	
<i>% Growth</i>	<i>27.1</i>	<i>13.7</i>	<i>27.4</i>	<i>11.0</i>	<i>12.3</i>	
Income from operations	173,135	204,702	271,205	307,766	348,662	
Raw material cost	117,855	140,070	190,253	216,561	243,826	
Power and fuel	2,378	2,585	3,274	3,476	3,952	
Employee cost	10,393	11,431	13,678	15,320	17,311	
Factory and administrative expenses	20,453	24,527	33,648	37,482	43,301	
Selling and advertising expenses	3,583	4,700	6,373	7,557	8,248	
Total operating expenses	154,662	183,314	247,226	280,395	316,638	
EBITDA	20,654	24,477	29,750	31,717	37,407	
Add: Manufactured goods capitalised	2,181	3,089	5,771	4,346	5,383	
Total other income	3,354	3,240	5,915	6,341	6,905	
PBDIT	24,008	27,717	35,664	38,057	44,312	
Amortisation of deferred expenses	671	738	850	1,050	1,200	
Interest	2,178	2,935	3,685	4,800	5,175	
Depreciation and amortisation	4,502	5,209	5,863	6,391	8,102	
Provisions	97	(97)	11	0	0	
Employee separation cost	42	40	3	0	0	
Profit before tax	16,519	18,891	25,253	25,816	29,835	
Provision for tax	4,150	5,245	6,597	6,454	7,160	
Adj. profit after tax*	12,370	13,646	18,656	19,362	22,675	
Extraordinary items	0	1,643	479	0	0	
Profits after tax	12,370	15,289	19,135	19,362	22,675	
Consolidated profit after tax*	13,853	15,638	21,221	22,384	26,676	
Shares outstanding	361.8	382.9	385.4	390.9	407.2	
Dividend per share	14.3	14.8	17.5	18.0	20.2	
Dividend payout (%)	41.8	37.1	35.3	36.3	36.3	

*Excluding extraordinary income/expenses

Common size metrics- as % of net revenues

Year to March	FY05	FY06	FY07	FY08E	FY09E
Operating expenses	89.3	89.6	91.2	91.1	90.8
Depreciation	2.6	2.5	2.2	2.1	2.3
Interest expenditure	1.3	1.4	1.4	1.6	1.5
EBITDA margins	11.9	12.0	11.0	10.3	10.7
Net profit margins	7.0	7.4	6.9	6.2	6.4

Growth metrics (%)

Year to March	FY05	FY06	FY07	FY08E	FY09E
Revenues	32.4	18.2	32.5	13.5	13.3
EBITDA	18.9	18.5	21.5	6.6	17.9
PBT	27.8	14.4	33.7	2.2	15.6
Adj. net profit	52.6	10.3	36.7	3.8	17.1
Adj. EPS	50.6	4.2	35.8	2.3	12.4

Balance sheet					(INR mn)
As on 31st March	FY05	FY06	FY07	FY08E	FY09E
Equity capital	3,618	3,829	3,854	3,909	4,072
Reserves & surplus	37,496	51,542	64,843	81,347	109,272
Shareholders funds	41,114	55,371	68,698	85,257	113,344
Deferred tax liability (Net)	5,653	6,225	7,868	7,868	7,868
Secured loans	4,898	8,228	20,220	40,260	39,555
Unsecured loans	20,056	21,141	19,871	15,654	10,134
Borrowings	24,954	29,368	40,091	55,914	49,689
Sources of funds	71,721	90,965	116,657	149,039	170,901
Gross block	66,120	79,716	87,758	111,952	149,418
Depreciation	34,543	44,015	48,945	55,336	63,439
Net block	31,577	35,700	38,813	56,616	85,980
Capital work in progress	5,388	9,512	25,133	27,133	23,633
Investments	29,121	20,152	24,770	32,344	32,344
Inventories	16,014	20,122	25,010	28,985	31,071
Sundry debtors	7,986	7,158	7,822	9,938	12,240
Cash and bank balances	20,050	11,194	8,268	10,772	10,460
Loans and advances	26,749	58,077	60,260	60,286	60,786
Other current assets	61	62	59	59	59
Total current assets	70,860	96,613	101,418	110,040	114,616
Sundry creditors and others	54,146	59,003	59,935	63,254	70,590
Provisions	11,261	12,150	13,643	13,900	15,101
Total current liab. and provisions	65,407	71,154	73,578	77,154	85,691
Net current assets	5,454	25,460	27,841	32,886	28,925
Others	182	141	101	61	20
Uses of funds	71,721	90,965	116,657	149,039	170,902
Book value per share (BV) (INR)	114	145	178	218	278

Cash flow statement					(INR mn)
Year to March	FY05	FY06	FY07	FY08E	FY09E
PBIT	17,209	20,588	26,795	28,525	32,824
Less: Actual tax paid	4,150	5,245	6,597	6,454	7,160
Less: Tax shield on interest	668	900	1,130	1,472	1,587
Add: Tax on interest & investment income	704	589	922	963	1,038
NOPLAT	13,096	15,031	19,990	21,562	25,115
Add: Depreciation	4,502	5,209	5,863	6,391	8,102
Gross cash flow	17,598	20,241	25,853	27,953	33,217
Less: Capital expenditure	8,989	13,457	24,596	26,194	33,966
Less: Working capital investment	(5,180)	(1,909)	3,775	2,772	(2,948)
Less: Increase in other assets	15,183	0	(2)	0	0
Add: Increase in other liab./provisions	7,303	557	648	257	1,201
Add: Extra-ordinary income	0	0	0	0	1
Free cash flow	5,909	9,250	(1,868)	(756)	3,401

Ratios

Year to March	FY05	FY06	FY07	FY08E	FY09E
ROE (%)	30.1	27.6	27.9	22.7	20.0
ROCE (%)	28.3	25.8	26.6	21.7	21.5
Inventory days	34	37	34	35	33
Debtors days	17	13	11	12	13
Fixed assets T/o (x)	2.6	2.6	3.1	2.7	2.3
Debt/Equity	0.6	0.5	0.6	0.7	0.4

Valuation parameters

Year to March	FY05	FY06	FY07	FY08E	FY09E
EPS (INR)	34.2	39.9	49.6	49.5	55.7
Adj. EPS (INR)	34.2	35.6	48.4	49.5	55.7
<i>Y-o-Y growth (%)</i>	<i>50.6</i>	<i>4.2</i>	<i>35.8</i>	<i>2.3</i>	<i>12.4</i>
Consolidated EPS	38.3	40.8	55.1	57.3	65.5
CEPS (INR)	46.6	53.5	64.9	65.9	75.6
P/E (x)	20.8	17.8	14.3	14.4	12.8
P/E (x) Consolidated	18.6	17.4	12.9	12.4	10.9
Price/BV (x)	6.3	4.9	4.0	3.3	2.6
EV/Sales (x)	1.3	1.3	1.0	0.9	0.8
EV/EBITDA (x)	11.3	11.0	9.4	9.2	7.9

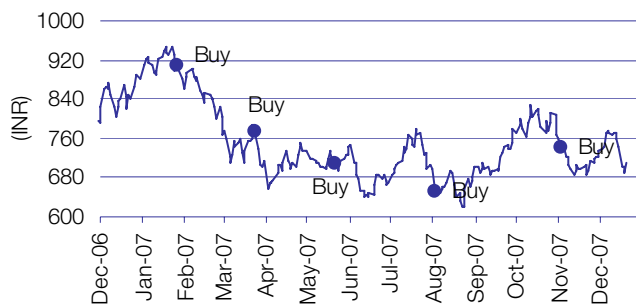
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Coverage group(s) of stocks by primary analyst(s): Auto/Auto Components:

Ashok Leyland, Tata Motors, Bajaj Auto Ltd, Maruti Udyog, Mahindra & Mahindra, Hero Honda Motors, TVS Motor, Bharat Forge and Amtek Auto

Tata Motors



Recent Research

Date	Company	Title	Price (INR)	Recos
18-Dec-07	Auto	Fact Sheet		
14-Dec-07	Auto	Sales Update		
20-Nov-07	Auto	Fact Sheet		
16-Nov-07	Auto	Sales update		

Distribution of Ratings / Market Cap

Edelweiss Research Coverage Universe

	Buy	Accumulate	Reduce	Sell	Total
Rating Distribution*	105	47	19	3	188

* 13 stocks under review / 1 rating withheld

	> 50bn	Between 10bn and 50 bn	< 10bn
Market Cap (INR)	99	67	22

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 20% over a 12-month period
Accumulate	appreciate up to 20% over a 12-month period
Reduce	depreciate up to 10% over a 12-month period
Sell	depreciate more than 10% over a 12-month period

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