

## Company Flash

31 October 2007 | 8 pages

# Tata Motors (TAMO.BO)

## Buy: 2QFY08 – One-Time Gains Mask Weak Results

- Recurring PAT declines 35% YoY** — Recurring PAT at Rs3.23bn (excluding forex gains and one-time gains related to transfer of technology to its subsidiaries and transfer of financing construction equipment to Tata Capital) declined 35% YoY (5% above our estimates). Capital gains tax rate of 10% is used for adjustment of one-time gains.
- EBITDA margins declined 264 bps YoY** — Margins at 9.2% (-264 bps y/y, +20 bps QoQ) were under pressure primarily due to a 3% decline in volumes and escalation in raw material costs.
- Consolidated results** — Reported consolidated PAT rose 6% Y/Y – reflecting strong performance of its subsidiaries. For 1HFY08, Tata Daewoo and Telcon reported stellar performance (PAT Up 62% and 116% YoY). The company suggested that it is looking at options of listing the subsidiary companies – but no time line was specified
- Conference call takeaways** — Key takeaways from the call were 1) Production constraint at Cummins for supply of engines has been resolved, 2) Overall company inventory levels have come down to 30 days from 35 days, 3) management remains optimistic of volume pickup in 2HFY08.
- Maintain Buy (1L)** — Recovery in CV volumes and listing of its unlisted subsidiaries remain key triggers to the stock in our view. Key risk factors remain a) margin pressures and b) large inorganic acquisitions.

|                              |              |
|------------------------------|--------------|
| <b>Buy/Low Risk</b>          | <b>1L</b>    |
| Price (31 Oct 07)            | Rs757.70     |
| Target price                 | Rs1,029.00   |
| Expected share price return  | 35.8%        |
| Expected dividend yield      | 2.0%         |
| <b>Expected total return</b> | <b>37.8%</b> |
| Market Cap                   | Rs290,332M   |
|                              | US\$7,386M   |

### Price Performance (RIC: TAMO.BO, BB: TTMT IN)



### Statistical Abstract

| Year to | Net Profit (RsM) | Diluted EPS (Rs) | EPS growth (%) | P/E (x) | P/B (x) | ROE (%) | Yield (%) |
|---------|------------------|------------------|----------------|---------|---------|---------|-----------|
| 31 Mar  |                  |                  |                |         |         |         |           |
| 2005A   | 12,474           | 34.48            | 45.9           | 22.0    | 6.7     | 32.4    | 1.6       |
| 2006A   | 14,023           | 34.60            | 0.3            | 21.9    | 5.2     | 29.1    | 1.7       |
| 2007E   | 18,412           | 45.43            | 31.3           | 16.7    | 4.3     | 30.0    | 2.0       |
| 2008E   | 22,523           | 55.57            | 22.3           | 13.6    | 3.5     | 30.0    | 2.1       |
| 2009E   | 25,411           | 62.69            | 12.8           | 12.1    | 2.9     | 27.7    | 2.2       |

Source: Powered by dataCentral

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<sup>1</sup>Citigroup Global Markets India Private Limited

Figure 1. Tata Motors- 1QFY08 Operational Details

|                         | 2Q FY07        | 2QFY08         | % chg<br>YoY | CIR Comments   |
|-------------------------|----------------|----------------|--------------|--|
| <b>Volumes (Nos.)</b>   |                |                |              |  |
| H / MCVs                | 43,453         | 39,866         | -8.3         | Domestic MHCV sales declined 11.4% y/y reflecting a) high interest rates which adversely impacted the goods segment and b) loss of market share to Eicher Motors and Ashok Leyland |
| LCVs                    | 36,565         | 37,562         | 2.7          | Primarily driven by the ACE, Winger and Magic variants received good response  |
| <b>Total CVs</b>        | <b>80,018</b>  | <b>77,428</b>  | <b>-3.2</b>  |  |
| UV s                    | 12,145         | 13,773         | 13.4         |  |
| Cars                    | 47,421         | 44,388         | -6.4         | Marketshare declined sharply due to success of new models by Maruti  |
| <b>Total Passenger</b>  | <b>59,566</b>  | <b>58,161</b>  | <b>-2.4</b>  |  |
| <b>Total</b>            | <b>139,584</b> | <b>135,589</b> | <b>-2.9</b>  |  |
| <b>Product mix (%)</b>  |                |                |              |  |
| H / MCVs                | 31.1           | 29.4           |              |  |
| LCVs                    | 26.2           | 27.7           |              |  |
| UV s                    | 8.7            | 10.2           |              |  |
| Cars                    | 34.0           | 32.7           |              |  |
| <b>Market share (%)</b> |                |                |              |  |
| H / MCVs                | 62.3           | 59.9           |              | Market share dips on Y/Y basis to Eicher and Ashok Leyland. Eicher gained share in goods segment due to its new products and Ashok Leyland gained share in the passenger segment   |
| LCVs                    | 68.1           | 62.8           |              | Loss of market share due to slowing growth rates of Ace  |
| UV s                    | 16.1           | 16.6           |              |  |
| Cars                    | 15.4           | 12.7           |              | Market share ceded to MUL  |

Source: SIAM, Company, Citi Investment Research

Figure 2. Tata Motors- 2QFY08 Financial Results

|                               | 2Q FY07       | 2QFY08        | % chg<br>YoY | CIR Comments   |
|-------------------------------|---------------|---------------|--------------|--|
| Gross Sales                   | 75,893        | 74,688        | -1.6         | Excludes 1) Rs 1694 million gain towards transfer of technology towards subsidiaries 2) Rs 300 million gain on transfer of activity related to financing of construction equipment to Tata Capital |
| Less: Excise duty             | 10,175        | 9,956         | -2.2         |  |
| <b>Net sales</b>              | <b>65,718</b> | <b>64,733</b> | <b>-1.5</b>  | <b>In line with estimates</b>  |
| Decrease/(Increase) in Stocks | (1,224)       | 718           |              |  |
| Raw Materials                 | 46,505        | 45,318        | -2.6         | In line with volume decline  |
| Staff costs                   | 3,427         | 3,694         | 7.8          | Reflects wage hikes taken in last quarter  |
| Other Expenses                | 9,231         | 9,049         | -2.0         |  |
| Total Expenditure             | 57,939        | 58,780        | 1.5          |  |
| <b>EBITDA</b>                 | <b>7,779</b>  | <b>5,953</b>  | <b>-23.5</b> | <b>4% above estimates</b>  |
| Forex gains                   | 254           | 309           |              | Gains primarily on account of forex denominated debt   |
| Product Development           | 175           | 188           | 7.2          |  |
| Interest                      | 956           | 965           | 1.0          |  |
| Other income                  | 848           | 707           | -16.7        |  |
| EBDT                          | 7,751         | 5,815         | -25.0        |  |
| Depreciation & Amortization   | 1,435         | 1,597         | 11.3         |  |
| PBT                           | 6,316         | 4,218         | -33.2        |  |
| Exceptional income            |               | 1,994         |              | Includes 1) Rs 1694 million gain towards transfer of technology towards subsidiaries 2) Rs 300 million gain on transfer of activity related to financing of construction equipment to Tata Capital |
| Exceptional expenditure       | (452)         |               |              |  |
| Tax                           | 1,447         | 944           | -34.8        |  |
| PAT                           | 4,417         | 5,268         | 19.3         |  |
| <b>PAT (pre exceptionals)</b> | <b>4,972</b>  | <b>3,234</b>  | <b>-34.9</b> | <b>5% above estimates, excludes forex and one time gains</b>   |
| <b>Profit Margins (%)</b>     |               |               |              |  |
| EBITDA (%) net sales          | 11.8          | 9.2           |              | Declined 264 bps y/y, 20 bps increase QoQ  |
| EBIT (%)                      | 8.4           | 5.8           |              |  |
| Pre tax margins (%)           | 8.3           | 5.6           |              |  |
| Tax / PBT (%)                 | 21.4          | 22.4          |              |  |
| Net profit margins (%)        | 6.6           | 4.3           |              |  |
| <b>Cost ratios (%)</b>        |               |               |              |  |
| Raw materials / sales         | 68.9          | 71.1          |              | 220 bps increase y/y, 140 bps QoQ, 110 bps above estimates   |
| Staff costs / sales           | 5.2           | 5.7           |              | In line with estimates   |
| Other expenses / sales        | 14.0          | 14.0          |              | 130 bps below estimates, down 150 bps QoQ  |

Source: Company, Citi Investment Research

## Tata Motors

### Company description

Tata Motors is the flagship company of the Tata Group, India's largest business conglomerate, and is among the country's largest manufacturers of automobiles with a dominant position in the commercial-vehicle business. It has a significant presence in the utility vehicle and passenger-car segments.

### Investment strategy

We have a Buy/Low Risk rating on Tata Motors, with our positive view reflecting a) the impending spinning off of the auto finance business (which will release substantial funds locked into the business and positively impact TTMT's return

/ asset turnover ratios and b) stronger-than-expected growth in heavy trucks as the ban on overloading continues to be implemented (not as effectively as we would like, but far better than we had initially envisaged).

Key reasons for a strong growth outlook in commercial vehicles include a sustained pick-up in economic activity, a focus on infrastructure spending (expected to continue with funding in place) and a strong replacement cycle (27% of the existing fleet in India is more than 15 years old and needs to be replaced both for commercial and environmental reasons).

Tata Motors should also benefit from the launch of new products and international initiatives, given a competitive cost structure.

## **Valuation**

Our 12-month target price of Rs1,029 is based on a sum-of-parts valuation methodology, which we believe captures the value embedded in subsidiaries and group holdings. Management has indicated its intent to unlock value, (to the benefit of Tamo's existing shareholders), for either / both HV Transmissions Ltd. and HV Axles Ltd., through an IPO or strategic sale to outside parties.

We value Tata Motors' core business at Rs 827 / share, which is based on 9.2x FY08E EBITDA, at the lower end of the recent trading band, and which should be comfortably supported by a 25% CAGR in EBITDA over FY06-08E. Over the past fiscal, the EV / EBITDA multiple has ranged between 6.2-11.4x. We value the subsidiaries at Rs201 / share.

## **Risks**

We rate Tata Motors Low Risk based on our quantitative risk rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price are movements in economic variables — particularly GDP growth, interest rates and fuel prices, to which sales of commercial and passenger vehicles are very sensitive. Competition in the passenger car business remains intense with the presence of most global majors in the Indian market. While the commercial vehicle business has been relatively less exposed to competition, the situation could change over the next three years with international companies eyeing the Indian market. Key upside risks to our target price include: a) Strategic sale/IPO of key subsidiaries; b) An indication that the Supreme Court ruling on overloading is being implemented over the longer term; and c) Reduction in input costs (notably steel).

# Appendix A-1

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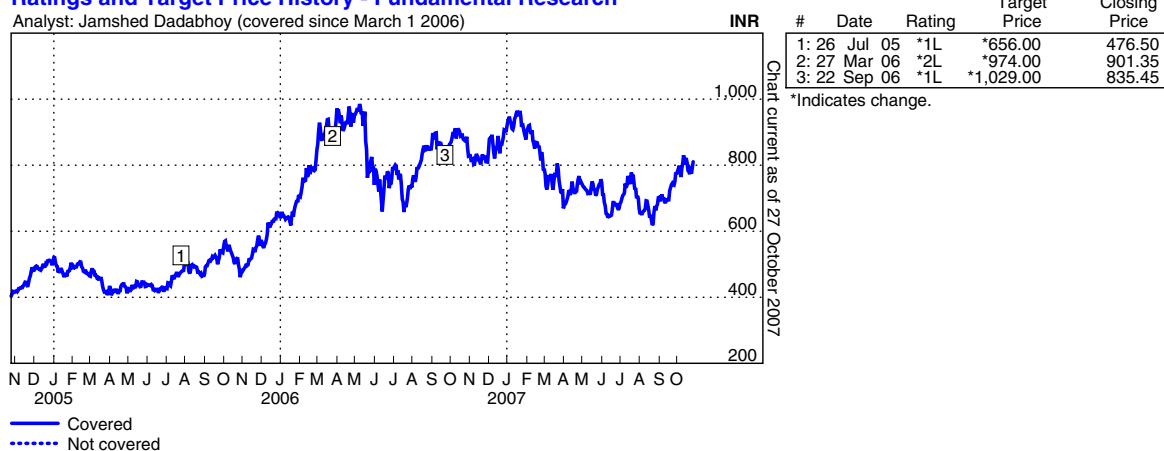
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Analyst: Jamshed Dadabhoy (covered since March 1 2006)



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53%

55%

42%

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