

TATA MOTORS

The awakening

India Equity Research | Automobiles

We attended the India business investor day organised by Tata Motors (TML) on June 5. Key takeaways are: 1) demand outlook—Commercial vehicles (CV) in an upcycle; management estimates 10-12% volume CAGR over FY18-20; outlook on passenger vehicles' (PV) demand is good as well 2) 3-5% FY19-21 EBIT margin guidance; 5-7% beyond FY21; 3) targeting competitive, consistent & cash accretive growth; this addresses investors' apprehension on price war in CV; 4) change in culture & approach towards customers, dealers & supplier engagements; 5) focusing on modularity to provide flexibility, customisation & reduce costs; and 6) tier 3 & 4 towns as well as rural areas on the radar. Management pegged capex at ~INR40bn p.a. primarily for product development. We maintain our earnings estimates and 'HOLD' rating. We will review the same post JLR's investor day, which is scheduled on June 22.

- **'Turnaround 1' initiative (FY16-18):** In this phase, focus was on new products, sales activation, improving profitability of dealers and suppliers and cost reduction. It led to ~INR19bn cost savings in FY18. Moreover, warranty costs have plummeted ~57% in CV and 64% in PV over the past three years.
- **'Turnaround 2' based on six key pillars:** Top line, customer centricity, process improvement, cost management, new business model/technology and lean & accountable organisation. Target is profitable and fit-for-future product portfolio.
- **Business-wise strategy:** In CV, focus is on strengthening product planning to address white spaces & inter-segmental shift and enhancing customer engagement. In PV, immediate focus is on sales enhancement via different approaches for diverse target customers—first-time buyer, second car owner and replacement customer—and introduction of modular ALFA architecture (in FY19).

Outlook and valuations: India well placed; maintain 'HOLD'

We believe, the India business is well placed to capitalise on demand uptick with a potential of positive surprise to our FY20E EBITDA of ~INR60bn. However, turnaround in JLR's free cash flow profile remains key trigger. We maintain 'HOLD' and SOTP-based TP of INR351.

Financials

(INR mn)

Year to March	FY17	FY18E	FY19E	FY20E
Revenues	2,696,925	2,946,192	3,197,548	3,449,483
Rev. growth (%)	(1.2)	9.2	8.5	7.9
Adjusted Profit	94,994	75,450	94,385	131,403
Basic shares outstanding (mn)	3,396	3,396	3,396	3,396
Adjusted diluted EPS (INR)	28.0	22.2	27.8	38.7
EPS Growth (%)	(48.0)	(20.6)	25.1	39.2
Diluted P/E (x)	10.6	13.3	10.6	7.6
EV/EBITDA (x)	4.2	4.3	3.1	2.7
ROAE (%)	13.9	9.9	9.4	11.9

EDELWEISS 4D RATINGS

Absolute Rating	HOLD
Rating Relative to Sector	Performer
Risk Rating Relative to Sector	High
Sector Relative to Market	Overweight

MARKET DATA (R: TAMO.BO, B: TTMT IN)

CMP	: INR 296
Target Price	: INR 351
52-week range (INR)	: 484 / 282
Share in issue (mn)	: 2,887.3
M cap (INR bn/USD mn)	: 943 / 13,560
Avg. Daily Vol.BSE/NSE('000)	: 9,725.2

SHARE HOLDING PATTERN (%)

	Current	Q3FY18	Q2FY18
Promoters *	42.9	36.4	36.4
MF's, FI's & BK's	20.8	17.1	15.3
FII's	23.9	21.4	22.6
Others	12.5	25.1	25.7
* Promoters pledged shares (% of share in issue)	:	8.9	

PRICE PERFORMANCE (%)

	Stock	Nifty	EW Auto Index
1 month	(14.3)	0.1	(2.5)
3 months	(22.7)	1.6	(1.1)
12 months	(40.1)	10.1	1.0

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Commercial vehicles: Win decisively

- TML has moved from mere transactional to deeper relationship with customers. The aim is to engage customers to understand their needs. This enabled relaunch of old *ACE* as *ACE Gold*.
- Improve visibility in live deals and big fleet operators. Presence has been improved from 50% to 80%. The share of sales to large fleet operators (> 30 trucks) is now at 35%
- **Improve dealer moral:** Raised dealer margin in certain cases; incentive structure is now quarterly rather than annual.
- **Focus on customer services:** 1) **Sampoorna Seva** – Clubbed all existing schemes into one with some innovation; 2) **Tata Alert** – Providing breakdown assistance with commitment to reach the location in four hours and ensure vehicle is up and running within 24 hours. TML currently has 245 dealers, 3,300 sales touch points and presence in 2,100 tehsils; 3) helped customers reduce oil consumption 33%; and 4) reducing spare part costs.
- **Reducing vehicle costs:** In the last few months, TML has organized 'Teardown workshops' to identify cost reduction opportunities. It has covered 36 vehicle models and involved ~2,500 people (employees, dealers, suppliers, etc) in these initiatives. Through this effort, the team achieved more than 2x the targeted cost reduction in identified areas.
- **Demand outlook:** Generally, the demand cycle lasts for five-eight years. Management expects low double digit growth during FY19 and FY20 given the current up cycle. Management anticipates scrappage policy to further boost demand.

Passenger vehicles: Win sustainably

- TML's aim is to be the No. 3 player in the domestic PV industry. Currently, it is the No. 4 player.
- TML aims to be amongst the top 3 car brands that a prospective consumer considers before buying a car.
- Strategy of staying away from the taxi segment has started paying off. Earlier, for TML, the taxi segment accounted for 85% of sales, while the segment contributed only 18% to industry. All the recent four launches (*Tiago*, *Tigor*, *Nexon*, *Hexa*) have evinced good consumer response. As a result, TML is outperforming industry since the past 24 months.
- Two-three years ago there was a debate for creating a new PV brand. However, over the past few quarters, everyone is convinced otherwise.
- Focus is on structural reduction of cost by way of modular architecture (end of FY19), vendor consolidation, internal efficiency improvement and early involvement of vendors.
- Enhanced dealer network from 445 to 746 and the number of cities covered from 359 to 626 during FY15-18.
- Different strategy for diverse type of customers:
 - **First-time buyer:** Share has dipped to 36% from 50% in the past seven-eight years. The share is too low for a country like India. Aim is to identify likely segments for first-time buyers and introduce specific models to gain first-mover advantage.

- **Second car owner:** Households with more than one car likely to increase. Hence, it aims to develop product portfolio to address this segment.
- **Replacement buyer:** Role of used vehicle market (company assured pre-owned cars) is very important for replacement buyers.
- **Rural market (including tier 4 & 5 towns):** Represents 35% of total market and has been the fastest growing. In FY18, this segment is estimated to have grown at ~20% versus all India growth of ~7%.

Power train strategy

- A complete power train accounts for ~35-40% of cost. Hence, an integrated strategy is critical for overall cost reduction.
- Also, power train is affected by regulation with respect to fuel economy, emission, noise, vibration and harshness (NVH) levels, etc.
- With rising cost of compliance, an effective power train strategy is vital to contain the total cost of ownership (TCO).
- The road map of various regulatory requirements that have been announced or under discussion:
 - **April 2017** – transition of BSIV, CAFÉ Norms (for PV)– Phase 1.
 - **April 2018** – FE Norms (for CV) – phase 1.
 - **April 2020** – transition to BSVI.
 - **April 2021** - FE Norms (for CV) – phase 2.
 - **April 2022** – CAFÉ Norms – phase 2.
 - **April 2023- BSVI (phase 2).**

Company Description

TTMT is India's largest commercial vehicle player and fourth largest player in the PV market with products in compact and mid size cars and utility vehicle segments. Through subsidiaries and associate companies, the company has operations in the UK, South Korea, Thailand and Spain. Among them is Jaguar Land Rover, the business comprising 2 iconic British brands – Jaguar and Land Rover. TTMT's cars, buses and trucks are being marketed in several countries across Europe, Africa, the Middle East, South Asia, South East Asia and South America.

Investment Theme

We remain positive on JLR's healthy product pipeline and believe platform consolidation will accelerate model introductions over next 5 years. However, increasing average portfolio age for JLR and higher discounting are likely to cap margin expansion. We expect FCF generation of domestic business to remain under pressure given huge capex and continued pressure on market share.

Key Risks

Domestic business: In PV business, TTMT continues to invest in a new platform due to for launch in 2019. Success of this platform is a key monitorable. In its commercial vehicle business, the company is unable to stem the loss of market share, despite having a wide distribution network and strong brand equity. This is likely to put pressure on its margin profile over long term driven by higher support activities.

Jaguar and Land Rover: Given competitive intensity, we expect profitability to lag volume growth. Electric vehicles remain a key event as it is unclear as of now the extent of success all the traditional players are likely to achieve.

Financial Statements

Key Assumptions

Year to March	FY17	FY18	FY19E	FY20E
Macro				
GDP(Y-o-Y %)	6.6	6.5	7.1	7.6
Inflation (Avg)	4.5	3.8	4.5	5.0
Repo rate (exit rate)	6.3	6.0	6.0	6.5
USD/INR (Avg)	67.1	64.5	65.0	66.0
Sector				
Cars - domestic vol. (% YoY)	4.0	8.0	8.0	8.0
MHCV - domestic vol (% YoY)	1.0	8.0	8.0	8.0
Company				
Revenue assumptions				
Domestic vol growth (% YoY)				
Cars - domestic vol. (% YoY)	26.0	14.5	8.3	9.6
MHCV - domestic vol (% YoY)	(5.0)	5.3	6.6	14.6
LCV - dom. vol. (% YoY)	6.5	26.7	14.1	15.2
Domestic avg. realisation (INR)	820,479.0	902,601.9	893,738.7	917,626.7
Domestic avg. realisation (% YoY)	(2.3)	10.0	(1.0)	2.7
JLR sales volume (Nos)				
Jaguar	169,284	172,738	184,941	198,165
Land Rover	373,509	390,393	431,658	457,484
Cost assumptions				
Net borrowings (INR mn)	125,280	(20,000)	(20,000)	(20,000)
RM cost/vehicle	579,775	659,103	647,804	667,626
Employee cost/vehicle	65,812	60,135	59,808	58,555
Average salary	1,366,822	1,448,831	1,564,737	1,658,622
Promotion cost (% revenue)	1.9	1.6	1.4	1.4
EBITDA/vehicle	23,048	56,165	67,459	56,907
Financial assumptions				
Avg. Interest rate (%)	10.2	9.0	7.0	6.5
Depreciation rate (%)	10.8	12.0	10.9	11.0
Dividend payout (%)	1.0	7.4	3.4	2.8
B/S assumptions				
Tax rate (%)	26.8	40.3	26.8	27.5
Debtor days	19	17	16	16
Inventory days	74	66	63	65
Payable days	254	228	201	178
Cash conversion cycle	(161)	(145)	(122)	(97)
Capex (INR mn)	174,380	325,500	300,300	298,700

Income statement

(INR mn)

Year to March	FY17	FY18	FY19E	FY20E
Income from operations	2,696,925	2,946,192	3,197,548	3,449,483
Materials costs	1,658,942	1,858,499	2,066,025	2,198,295
Manufacturing expenses	11,720	-	17,713	20,231
Employee costs	283,329	303,001	299,315	327,704
Total SG&A expenses	576,716	637,161	460,563	504,023
Expenses capitalised	168,770	185,881	5,568	11,761
Total operating expenses	2,361,937	2,612,780	2,838,048	3,038,492
EBITDA	334,988	333,412	359,500	410,991
Depreciation	179,050	215,536	244,408	260,174
EBIT	155,938	117,876	115,092	150,817
Less: Interest Expense	42,380	46,818	24,453	18,366
Add: Other income	7,545.4	8,888.9	11,612.01	12,876.01
Profit Before Tax	93,148	111,551	102,251	145,327
Less: Provision for Tax	32,512	43,419	25,024	34,203
Less: Minority Interest	1,022	1,025	-	-
Add: Exceptional items	(27,955)	31,604	-	-
Associate profit share	14,930	22,783	17,158	20,279
Reported Profit	74,544	89,890	94,385	131,403
Exceptional Items	(20,450)	14,440	-	-
Adjusted Profit	94,994	75,450	94,385	131,403
Shares o/s (mn)	3,396	3,396	3,396	3,396
Adjusted Basic EPS	28.0	22.2	27.8	38.7
Diluted shares o/s (mn)	3,396	3,396	3,396	3,396
Adjusted Diluted EPS	28.0	22.2	27.8	38.7
Adjusted Cash EPS	80.7	85.7	99.8	115.3
Dividend per share (DPS)	0.2	1.2	1.2	1.2
Dividend Payout Ratio(%)	1.0	5.1	4.8	3.5

Common size metrics

Year to March	FY17	FY18	FY19E	FY20E
Materials costs	61.5	63.1	64.6	63.7
Staff costs	10.5	10.3	9.4	9.5
S G & A expenses	15.1	15.3	14.2	14.3
Operating expenses	87.6	88.7	88.8	88.1
Depreciation	6.6	7.3	7.6	7.5
EBITDA margins	12.4	11.3	11.2	11.9
Interest Expense	1.6	1.6	0.8	0.5
Net Profit margins	3.6	2.6	3.0	3.8

Growth ratios (%)

Year to March	FY17	FY18	FY19E	FY20E
Revenues	(1.2)	9.2	8.5	7.9
EBITDA	(20.3)	(0.5)	7.8	14.3
PBT	(47.8)	19.8	(8.3)	42.1
Adjusted Profit	(48.0)	(20.6)	25.1	39.2
EPS	(48.0)	(20.6)	25.1	39.2

Balance sheet (INR mn)				
As on 31st March	FY17	FY18	FY19E	FY20E
Share capital	6,792	6,792	6,792	6,792
Reserves & Surplus	573,828	947,487	1,030,917	1,157,749
Shareholders' funds	580,620	954,279	1,037,709	1,164,541
Minority Interest	4,532	5,251	5,251	5,251
Long term borrowings	618,566	653,618	578,566	558,566
Short term borrowings	126,325	126,325	126,325	126,325
Total Borrowings	744,891	779,944	704,891	684,891
Def. Tax Liability (net)	11,739	61,258	61,258	61,258
Sources of funds	1,341,782	1,800,731	1,809,109	1,915,940
Gross Block	1,628,389	2,104,191	2,378,551	2,677,251
Net Block	434,680	641,579	561,129	571,414
Capital work in progress	336,988	400,335	316,585	316,585
Intangible Assets	524,761	572,559	676,578	704,819
Total Fixed Assets	1,296,429	1,614,474	1,554,292	1,592,818
Cash and Equivalents	343,247	355,295	587,578	598,727
Inventories	350,853	421,376	371,880	401,621
Sundry Debtors	140,756	198,933	147,494	156,848
Loans & Advances	606,259	723,427	534,159	367,841
Current Assets (ex cash)	1,097,868	1,343,737	1,053,533	926,310
Trade payable	1,247,640	1,323,755	1,162,201	961,896
Other Current Liab	148,122	189,019	224,093	240,019
Total Current Liab	1,395,762	1,512,774	1,386,294	1,201,915
Net Curr Assets-ex cash	(297,894)	(169,037)	(332,761)	(275,605)
Uses of funds	1,341,782	1,800,731	1,809,109	1,915,940
BVPS (INR)	171.0	281.0	305.6	342.9

Free cash flow (INR mn)				
Year to March	FY17	FY18	FY19E	FY20E
Reported Profit	74,544	89,890	94,385	131,403
Add: Depreciation	179,050	215,536	244,408	260,174
Interest (Net of Tax)	31,002	21,391	18,469	14,044
Others	63,595	(271,755)	321,820	(122,866)
Less: Changes in WC	15,393	(128,857)	163,724	(57,156)
Operating cash flow	332,799	183,919	515,358	339,910
Less: Capex	174,380	539,149	190,609	298,700
Free Cash Flow	158,419	(355,231)	324,748	41,210

Cash flow metrics				
Year to March	FY17	FY18	FY19E	FY20E
Operating cash flow	332,799	183,919	515,358	339,910
Financing cash flow	82,169	(16,337)	(104,077)	(42,938)
Investing cash flow	(132,543)	(535,008)	(174,249)	(285,824)
Net cash Flow	282,425	(367,427)	237,032	11,149
Capex	(174,380)	(539,149)	(190,609)	(298,700)
Dividend paid	(730)	(4,572)	(4,572)	(4,572)

Profitability and efficiency ratios				
Year to March	FY17	FY18	FY19E	FY20E
ROACE (%)	11.9	8.3	7.3	9.1
ROAE (%)	13.9	9.9	9.4	11.9
Inventory Days	74	76	69	64
Debtors Days	19	21	20	16
Payable Days	254	253	218	175
Cash Conversion Cycle	(161)	(156)	(128)	(95)
Current Ratio	1.0	1.1	1.2	1.3
Gross Debt/EBITDA	2.2	2.3	2.0	1.7
Gross Debt/Equity	1.3	0.8	0.7	0.6
Adjusted Debt/Equity	1.3	0.8	0.7	0.6
Net Debt/Equity	0.7	0.4	0.1	0.1
Interest Coverage Ratio	3.7	2.5	4.7	8.2

Operating ratios				
Year to March	FY17	FY18	FY19E	FY20E
Total Asset Turnover	1.9	1.9	1.8	1.9
Fixed Asset Turnover	2.7	2.7	2.6	2.7
Equity Turnover	3.9	3.8	3.2	3.1

Valuation parameters				
Year to March	FY17	FY18	FY19E	FY20E
Adj. Diluted EPS (INR)	28.0	22.2	27.8	38.7
Y-o-Y growth (%)	(48.0)	(20.6)	25.1	39.2
Adjusted Cash EPS (INR)	80.7	85.7	99.8	115.3
Diluted P/E (x)	10.6	13.3	10.6	7.6
P/B (x)	1.7	1.1	1.0	0.9
EV / Sales (x)	0.5	0.5	0.4	0.3
EV / EBITDA (x)	4.2	4.3	3.1	2.7
Dividend Yield (%)	0.1	0.4	0.4	0.4

Peer comparison valuation

Name	Market cap (USD mn)	Diluted P/E (X)		EV / EBITDA (X)		P/B (X)	
		FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
Tata Motors Ltd	13,560	10.6	7.6	3.1	2.7	1.0	0.9
Ashok Leyland	6,397	23.4	18.3	12.5	9.8	5.3	4.6
Mahindra & Mahindra Ltd	16,700	20.7	17.5	12.6	10.1	3.1	2.7
Median	-	20.7	17.5	12.5	9.8	3.1	2.7
AVERAGE	-	18.2	14.5	9.4	7.5	3.1	2.7

Source: Edelweiss research

Additional Data

Directors Data

N N Wadia	Non-Executive Independent Directors	R A Mashelkar	Non-Executive Independent Directors
S Bhargava	Non-Executive Independent Directors	N Munjee	Non-Executive Independent Directors
V K Jairath	Non-Executive Independent Directors	R Sen	Non-Executive Independent Directors
Cyrus P Mistry	Chairman, Non-Executive Director	Ralf Speth	Other Non-Executive Directors
Ravindra Pisharody	Executive Directors	Satish Borwankar	Executive Directors

Auditors - Deloitte Haskins & Sells

**as per last annual report*

Holding – Top10

	Perc. Holding		Perc. Holding
Tata sons ltd	33.3	Citibank na	15.56
Life insurance corp	5.17	Tata industries ltd	2.5
Blackrock	2.31	Reliance capital tru	1.9
Icici prudential lif	1.63	Govt of singapore	1.58
Vanguard group	1.28	Fil limited	1.05

**in last one year*

Bulk Deals

Data	Acquired / Seller	B/S	Qty Traded	Price
23 Jun 2017	Tata Sons Ltd	Buy	83537697	452.80
23 Jun 2017	Tata Steel Ltd	Sell	83537697	452.80

**in last one year*

Insider Trades

Reporting Data	Acquired / Seller	B/S	Qty Traded
20 Mar 2018	Tata Sons Ltd	Buy	1668160.00
20 Sep 2017	Tata sons Ltd	Buy	47205617.00
25 Jul 2017	Tata sons Ltd	Buy	83537697.00
28 Jun 2017	Tata sons Ltd	Buy	83537697.00

**in last one year*

Company	Absolute reco	Relative reco	Relative risk	Company	Absolute reco	Relative reco	Relative Risk
Amara Raja Batteries	BUY	None	None	Ashok Leyland	BUY	SO	H
Bajaj Auto	HOLD	SU	L	Ceat Ltd	BUY	SO	L
Eicher Motors	BUY	SO	M	Exide Industries	BUY	None	None
Hero MotoCorp	HOLD	SU	H	Mahindra & Mahindra Ltd	BUY	SO	M
Maruti Suzuki India Ltd	BUY	SO	H	Minda Corporation	BUY	SO	M
Motherson Sumi Systems	BUY	SO	H	Suprajit Engineering	BUY	SO	H
Tata Motors Ltd	HOLD	SP	H				

ABSOLUTE RATING

Ratings	Expected absolute returns over 12 months
Buy	More than 15%
Hold	Between 15% and - 5%
Reduce	Less than -5%

RELATIVE RETURNS RATING

Ratings	Criteria
Sector Outperformer (SO)	Stock return > 1.25 x Sector return
Sector Performer (SP)	Stock return > 0.75 x Sector return
	Stock return < 1.25 x Sector return
Sector Underperformer (SU)	Stock return < 0.75 x Sector return

Sector return is market cap weighted average return for the coverage universe within the sector

RELATIVE RISK RATING

Ratings	Criteria
Low (L)	Bottom 1/3rd percentile in the sector
Medium (M)	Middle 1/3rd percentile in the sector
High (H)	Top 1/3rd percentile in the sector

Risk ratings are based on Edelweiss risk model

SECTOR RATING

Ratings	Criteria
Overweight (OW)	Sector return > 1.25 x Nifty return
Equalweight (EW)	Sector return > 0.75 x Nifty return
	Sector return < 1.25 x Nifty return
Underweight (UW)	Sector return < 0.75 x Nifty return

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Coverage group(s) of stocks by primary analyst(s): Automobiles

Ashok Leyland, Amara Raja Batteries, Bajaj Auto, Ceat Ltd, Eicher Motors, Exide Industries, Hero MotoCorp, Minda Corporation, Mahindra & Mahindra Ltd, Maruti Suzuki India Ltd, Motherson Sumi Systems, Suprajit Engineering, Tata Motors Ltd

Recent Research

Date	Company	Title	Price (INR)	Recos
31-May-18	Suprajit Engineering	Weak quarter; outlook remains strong; <i>Result Update</i>	279	Buy
29-May-18	Minda Corporation	Muted performance; upbeat guidance; <i>Result Update</i>	184	Buy
29-May-18	Mahindra & Mahindra	Strong show; sanguine outlook; <i>Result Update</i>	870	Buy

Distribution of Ratings / Market Cap

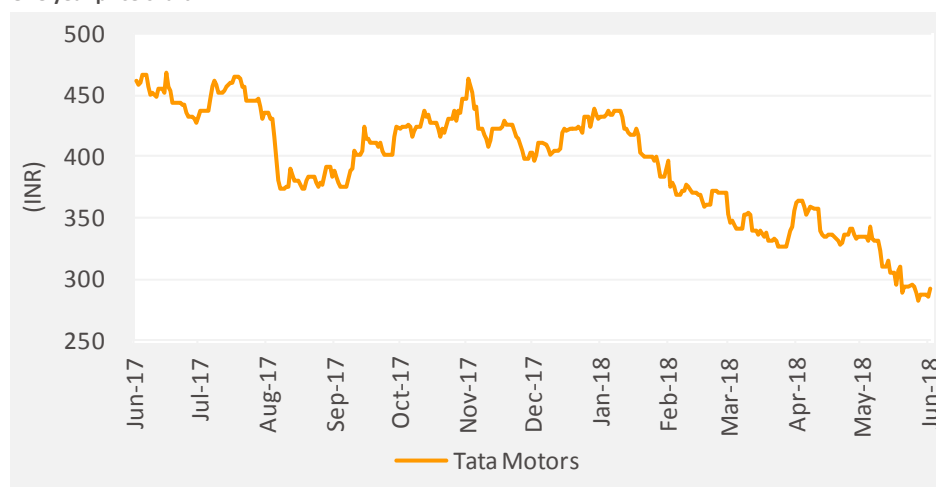
Edelweiss Research Coverage Universe

	Buy	Hold	Reduce	Total
Rating Distribution*	161	67	11	240
* 1stocks under review				
	> 50bn	Between 10bn and 50 bn	< 10bn	
Market Cap (INR)	156	62	11	

Rating Interpretation

Rating	Expected to
Buy	appreciate more than 15% over a 12-month period
Hold	appreciate up to 15% over a 12-month period
Reduce	depreciate more than 5% over a 12-month period

One year price chart



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