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In Focus

Tata Motors

Market Performer

Rs 852

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Q2 FY07 Result Update – CV price increase does not help

India's largest commercial vehicle manufacturer, Tata Motors, announced lower-than-expected profits for Q2, with the EBITDA margin withering under the twin impact of input and sales cost pushes. Net sales rose 37.4% yoy, to Rs 65.72bn, following a good sales (vehicle volumes) performance growth of 29.9%. Driving the higher net sales growth was a spurt in CVs (42.1% yoy) in the domestic market, which raised their overall composition in the sales mix to 51% (compared to 46.8% a year ago). Adjusted PAT grew by a slower 30.3% yoy to Rs 4.42bn.

Absolute EBITDA increased 31.6% to Rs 7.58bn but still meant that the margin was 51bp down to 11.5%. However, accounting for the two extraordinary items, forex gain and a one-time salary benefit, coupled with maintenance expense correction, the EBITDA margin still fell 58bp, from 12.5% to 11.9%. Net interest expense more than doubled to Rs 956m due to the greater drawing down of loans to fund the vehicle-financing arm. This arm, now a separate company called TML Financial Services Ltd., in Q2 FY07 disbursed loans of Rs 20.9bn to finance the purchase of TM vehicles (up 78% yoy).

Tata Motors reported (consolidated) net sales of Rs 77.03bn (a 54% yoy growth) and a PAT of Rs 5.36bn (a 36% yoy growth). Margin erosion, by 56bp to 12%, was the chief highlight of the results.

For FY07 we have lowered our EPS estimates -- by 12.6% (but only by 3.9% on the consolidated EPS) and for FY08 by 11.1% (a 2.7% decrease) by revisiting our volume expectations for the CV sector in general and by adjusting the average realisation in the light of the altered product mix. We believe that the recent upturn in the sector is unlikely to be sustained in the coming months, and expect overall growth in M&H CV sales during the year (FY07) to just about 4.5%. Tata Motors could expand the EBITDA margin, given that it has twice hiked product prices this year so far. Hence, we are retaining our rating to **MARKET PERFORMER** at ruling valuations of 17.5x FY08E diluted EPS of Rs 48.6. On a consolidated basis, the scrip is available at 12.5x FY08E EPS of Rs 57.

Key Figures (standalone)

Y/e March	FY05	FY06	FY07E	FY08E
Net Sales (Rs m)	174,191	206,022	244,787	274,813
EBITDA (Rs m)	21,711	25,797	29,416	33,928
Adjusted PAT (Rs m)	12,508	13,755	16,639	18,955
PAT Growth (%)	44.9	10.0	21.0	13.9
Diluted EPS (Rs)	32.0	35.2	42.6	48.6
PER (x)	26.6	24.2	20.0	17.5
EV / EBITDA (x)	13.1	12.6	10.6	9.9
EV / Sales (x)	1.6	1.6	1.3	1.2
RoE (%)	32.6	28.6	26.5	24.1
RoCE (%)	21.8	18.9	19.6	18.3

(Stock price as on July 26, 2006)



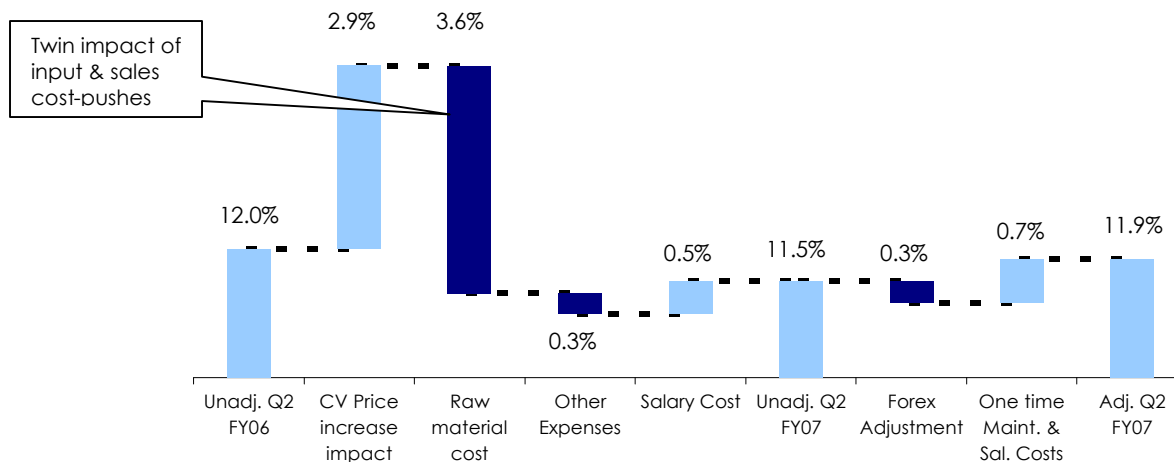
Key Figures (consolidated)

Y/e March	FY05	FY06	FY07E	FY08E
Net Sales (Rs m)	194,401	235,879	281,949	320,961
EBITDA (Rs m)	24,038	29,236	30,972	35,972
Adjusted PAT (Rs m)	13,971	17,355	19,156	22,248
PAT Growth (%)	50.9	24.2	10.4	16.1
Adj. EPS (Rs)	35.8	44.5	49.1	57.0
PER (x)	19.9	16.0	14.5	12.5
EV / EBITDA (x)	11.0	10.0	9.8	8.6
EV / Sales (x)	1.4	1.2	1.1	1.0
RoE (%)	34.7	33.0	28.1	26.8
RoCE (%)	22.2	21.1	19.0	18.7

Margins wither

Despite the substantial price hikes that Tata Motors managed on the CVs, one in Dec.'05 and another in Jun.'06, the EBITDA margins withered this quarter. Under the twin impact of input and sales cost pushes, the absolute EBITDA increased only 31.6%, leaving Tata Motors with a margin of 11.5%. However, accounting for the two extraordinary items—forex gain and the one-time salary benefit coupled with maintenance expense correction—the EBITDA margin still fell 58bp, from 12.5% (unadjusted Q2 FY06 was actually 12%) to 11.9%.

EBITDA margin withers under the twin impact of input and sales cost pushes



Source: Company Data, PL Research

We estimate that Tata Motors could have raised its EBITDA margin by 290bp through the CV price hikes alone. But higher incentives offered in order to extend market-share gains and higher raw material costs mostly attributable to the unprecedented tyre price hikes resulted in a margin loss of about 70bp. The rest of the items were mostly self-cancelling in their combined impact.



Tata Motor Finance (TMF) hived off into TML Financial Services Ltd

TMF, which finances Tata vehicles, had considerably raised the balance sheet due to the mounting vehicle financing disbursements. As of end-September, Tata Motors' balance sheet size was Rs 117.3bn and almost half (Rs 51.3bn) of it was TMF business. This constrained its ability to raise funds. A separate company called TML Financial Services Ltd. has now commenced operations in Sep.'06. Tata Motors has yet to hive off its assets (and liabilities) into this new company but has invested Rs 3.5bn in the equity so far. A demerger would help it raise funds independent of Tata Motors and achieve its growth objective. The growth in its disbursements to finance Tata Motor vehicles was up 78% yoy in Q2 FY07 to Rs 20.9bn while it was up 97% in H1 FY07 to Rs 41.8bn. We understand that a strategic partner would assume a stake in the new hived-off entity. This, in our opinion, completes the full circle on the Tata Finance rescue act. A new stakeholder could mean the sharing of the TMF business value and hence not really value-accretive to shareholders.

Conference call highlights

With no volume guidance, Tata Motors explained that a strong replacement demand in CVs is expected to drive growth in the coming months. But considering the high base sales volumes of H2 FY06, we expect a 13.6% yoy decline in CV volumes to 124,474. The company spent Rs 9bn in the six months of this fiscal as capex. Over the next three or four years, capex is expected to be Rs 100bn. Elaborating on its capex plans, management clarified that Rs 22bn to Rs 23bn would be spent this year itself. Management also revealed that the Fiat alliance is progressing well and details of the new JV would be announced in a few months. New facilities for Ace are coming up at the greenfield plant in Rudrapur and are expected to be commissioned in H1 FY08. Giving the update on the fire at its car plant, management expressed satisfaction on the efforts made to revive full-scale operations. November would be the month of full-scale production. In the intervening period however, the company believes it has lost volumes of 4,000 to 5,000, though not resulting in financial losses on account of adequate insurance cover has resulted in market-share losses.

Volume estimates altered

We have re-visited our volume assumptions and have raised the M&H CV estimates by almost 10,000 units, reflecting the unexpected strong Q2 sales performance.

Product mix altered

Volume	Revised		Earlier		Change	
	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E
M&H CVs	146,027	149,869	135,918	139,158	10,109	10,711
LCVs	128,582	154,298	132,651	159,181	(4,069)	(4,883)
MUVs	46,606	47,742	42,506	43,519	4,100	4,223
Cars	182,957	201,253	182,957	201,253	-	-
Total	504,172	553,162	494,032	543,111	10,140	10,051

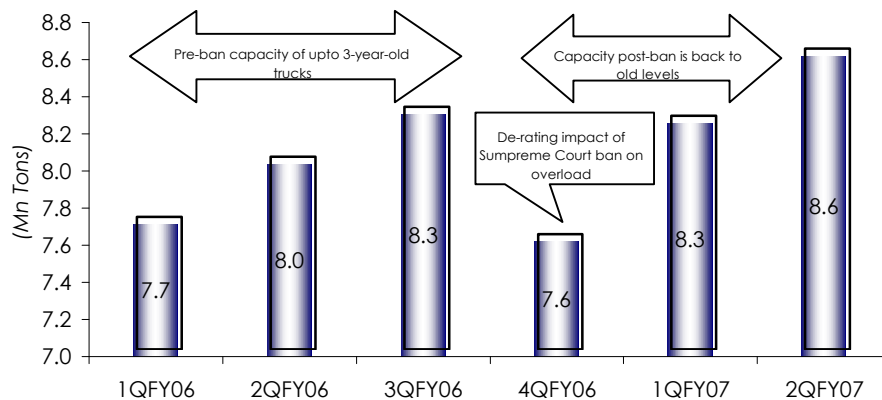
However, despite this change in volumes for FY07 we have marginally lowered our EPS estimates -- by 12.6% (but only by 3.9% on the consolidated EPS); for FY08, by 11.1% (a 2.7% decrease). We believe that the recent upturn in the CV sector is unlikely to be sustained in the coming months and expect overall growth in M&H CV sales during the year (FY07) to be just about 4.5%.



Trucking Capacity on the brink of correction

With clear evidence of ample accumulation in new CVs, we believe that the truck capacity, having had an accelerated build-up in the recent past, would see a correction. This is despite the ban on overloading by Supreme Court, a move that had a de-rating impact on the truck capacity in general. Truck capacity has in the last two quarters rapidly risen and is back at the pre-ban overloading capacity levels.

Back to the pre-ban capacity levels



Source:SIAM, PL research

Outlook

We expect Tata Motors to expand its EBITDA margin in H2 FY07, given that it has twice hiked product prices this year so far. The EBITDA margin would be bettered to 12.8% in H2 FY07, from 11.3% for the first half of this fiscal. But given the bleak outlook on volumes, we expect a 21% adjusted PAT growth this year to Rs 16.64bn. Hence, we are retaining our rating to **MARKET PERFORMER** at ruling valuations of 13.9x FY08E diluted EPS of Rs 48.6. On a consolidated basis, the scrip is available at 12.5x FY08E EPS of Rs 57.



Q2 FY07 Result Overview (standalone)

(Rs m)

Y/e March	Q2 FY07	Q2 FY06	YoY Gr. (%)	Q1 FY07	H1 FY07	H1 FY06	YoY Gr. (%)	FY06	FY07E	YoY Gr. (%)
Net Sales	65,718	47,813	37.4	57,834	123,552	86,594	42.7	206,022	244,787	18.8
Expenditure										
Raw Materials	46,505	33,776	37.7	42,651	89,156	62,593	42.4	142,639	165,966	16.4
Change in Stock	(1,224)	(1,165)		(3,853)	(5,078)	(4,860)		(2,569)	-	
<i>as % of Net Sales</i>	<i>68.9</i>	<i>68.2</i>	<i>70</i>	<i>67.1</i>	<i>68.1</i>	<i>66.7</i>		<i>68.0</i>	<i>67.8</i>	
Personnel Cost	3,427	2,742	25.0	3,024	6,451	5,502	17.3	11,431	13,547	18.5
<i>as % of Net Sales</i>	<i>5.2</i>	<i>5.7</i>		<i>5.2</i>	<i>5.2</i>	<i>6.4</i>		<i>5.5</i>	<i>5.5</i>	
Mfgr. Expenses	9,428	6,700	40.7	9,646	19,074	12,721	49.9	28,724	35,858	24.8
<i>as % of Net Sales</i>	<i>14.3</i>	<i>14.0</i>		<i>16.7</i>	<i>15.4</i>	<i>14.7</i>		<i>13.9</i>	<i>14.6</i>	
Total Expenditure	58,135	42,053	38.2	51,468	109,602	75,956	44.3	180,225	215,371	19.5
EBITDA	7,583	5,760	31.6	6,366	13,950	10,638	31.1	25,797	29,416	14.0
<i>EBITDA Marg. (%)</i>	<i>11.5</i>	<i>12.0</i>	<i>(51)</i>	<i>11.0</i>	<i>11.3</i>	<i>12.3</i>		<i>12.5</i>	<i>12.0</i>	
Depreciation	1,610	1,330	21.1	1,514	3,124	2,670	17.0	5,947	6,482	9.0
EBIT	5,973	4,430	34.8	4,853	10,826	7,968	35.9	19,850	22,934	15.5
Net Interest	956	461	107.5	726	1,681	971	73.2	2,264	2,862	26.4
Non-Operating Inc.	848	580	46.2	859	1,707	1,163	46.8	1,248	1,821	45.9
PBT	5,866	4,550	28.9	4,986	10,852	8,160	33.0	18,834	21,893	16.2
Tax	1,448	1,161	24.7	1,168	2,616	2,035	28.6	5,079	5,254	3.5
<i>Tax Rate %</i>	<i>24.7</i>	<i>25.5</i>		<i>23.4</i>	<i>24.1</i>	<i>24.9</i>		<i>27.0</i>	<i>24.0</i>	
Adj. Profit after Tax	4,417	3,389	30.3	3,819	8,236	6,126	34.4	13,755	16,639	21.0
Extraord. Income	-	-		-	-	-		1,574	-	
Extraord. Expenses	-	10		-	-	10		40	-	
Reported Profit	4,417	3,379	30.7	3,819	8,236	6,115	34.7	15,289	16,639	8.8

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