

March 28, 2017  
Company Update

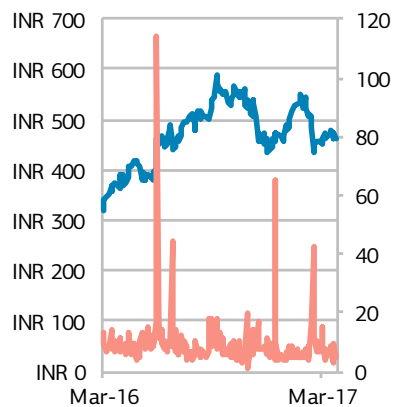
**Qin Shengxian**  
qin@jcapitalresearch.com

+852 2534 7405

## Tata Motors Ltd. (TTMT IN)

Stock Price	INR 462
Market Cap	INR 1,476 bln
<b>Rating</b>	<b>SELL</b>
<b>Price Target</b>	<b>INR 406</b>
Difference	12.2%

Tata Motors Ltd. (TTMT IN)  
last share price in INR (left, pink) and  
volume in mln shares (right, blue)



Source: Bloomberg

## Tata Motors Ltd. (TTMT IN)

# Victim of Its Own Success

### ▶ Domestically produced vehicles crowding out higher margin imports

Tata's China joint venture, CJLR, has significantly improved sales volume. But the domestic vehicles are crowding out the market for higher-margin imported cars. Imported vehicles sold to Mainland China have declined to 43% of sales volume in China and are growing slowly due to the price differential between imports sold in China and overseas.

### ▶ Sales underperforming and channel inventory rising

JLR's 30% sales-growth target for dealers this year outstrips what we estimate as 10-20% growth in Q1. Consequently, inventories have risen to about two months. Furthermore, 25-30% of vehicles are selling to downstream dealers, meaning there is a risk of channel stuffing.

### ▶ Dealers taking a 10% hit from higher discounts

Dealers are losing 10% per sale on the China-made vehicles due to high discounts on the Evoque (21-26%), Discovery Sport (14-21%), and XFL (5-12%).

### ▶ Valuation TP INR406 downside 12.2%

We reopen coverage of Tata with a target price of INR 406 per share. Our price is based on a SOTP valuation and values JLR at a FY18e PE ratio of 8x (average of the multiples of BMW & Daimler) and all India business at 9x EV/EBITDA. We value the China JLR business at a 9x FY19E P/E, the average of Brilliance China and BAIC).

Responsible for this report:

**Anne Stevenson-Yang**

anne@jcapitalresearch.com

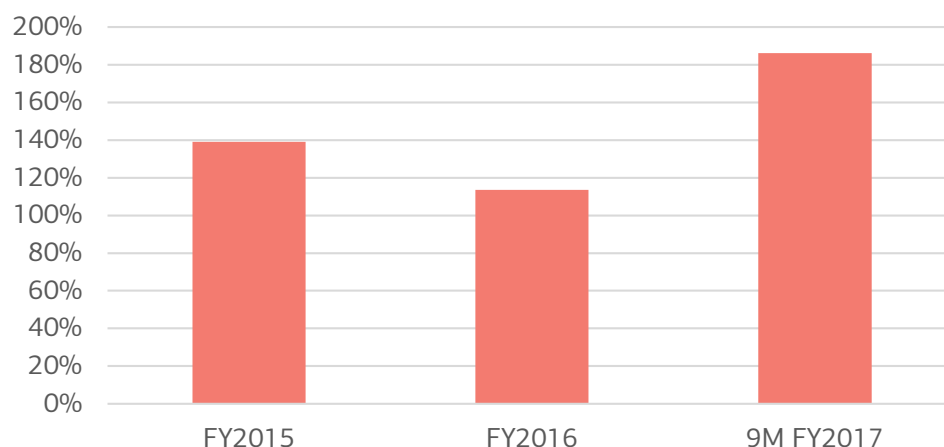
+852 2534 7405

# Tata Casts Its Lot with a Volatile China Market

For the first nine months of FY 2017, JLR's net revenue increased 15% YoY, to GBP 18.0 bln, accounting for 75% of Tata Motors Ltd.'s total revenue. And JLR's profit after tax (PAT) of GBP 715 mln, despite a 15% YoY decline, still makes up for the losses of Tata's other businesses.

We estimate that China's total profit contribution to Tata, including JV vehicles, imported vehicles, and auto parts, will reach 42% in FY 2017.

**Chart 1. JLR's Profit Contribution to Tata**



Source: Company data

Since our last update, in August 2015, sales for Tata's Jaguar Land Rover division—which operates a joint venture manufacturing facility in China called Chery-JLR (CJLR)—have gradually picked up. CJLR, which started production in 2014, has launched three models: the Evoque (2015 Feb), Discovery Sport (2015 Oct) and Jaguar XFL (2016 Sep).

Two years ago, Chinese buyers shunned the CJLR Land Rover Evoque due to the reputation of the JV partner, Chery, for low-end vehicles. However, with more dealership expansion and two more models successfully

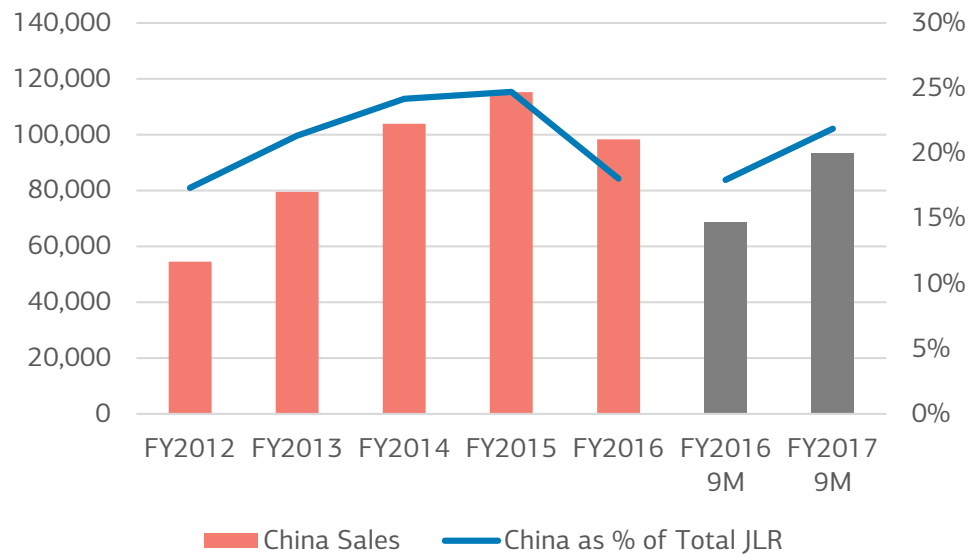
**Table 1. Sales Volume Growth Imported vs. Domestic JLR Vehicles**

YoY Change in Sales Volume	FY2016	FY2017 9M
China Imports	-42.9%	-6.6%
CJLR	759%	318%

Source: Company reports

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**Chart 2. China Sales Volume as % of Total JLR Sales**

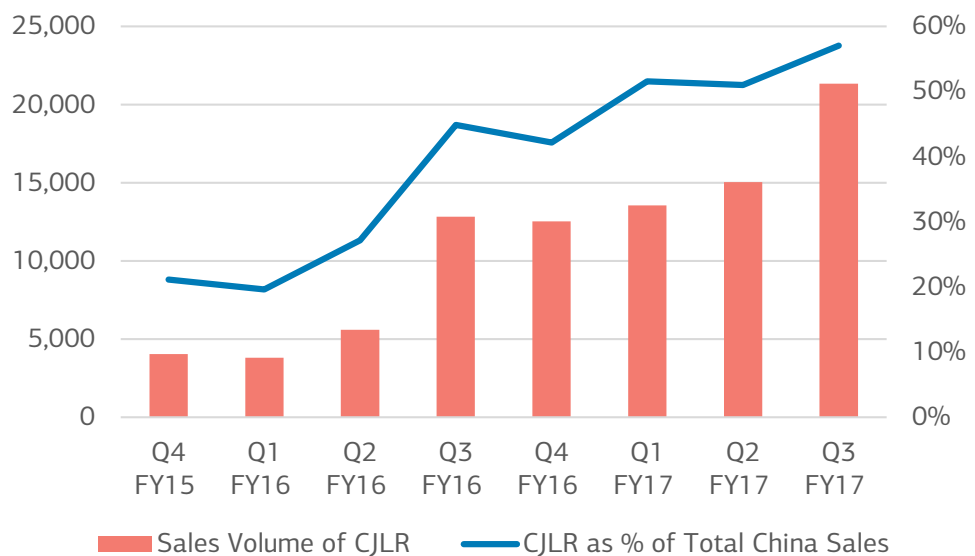


Source: Company data

launched at the end of 2015, CJLR saw strong sales volume growth in 2016.

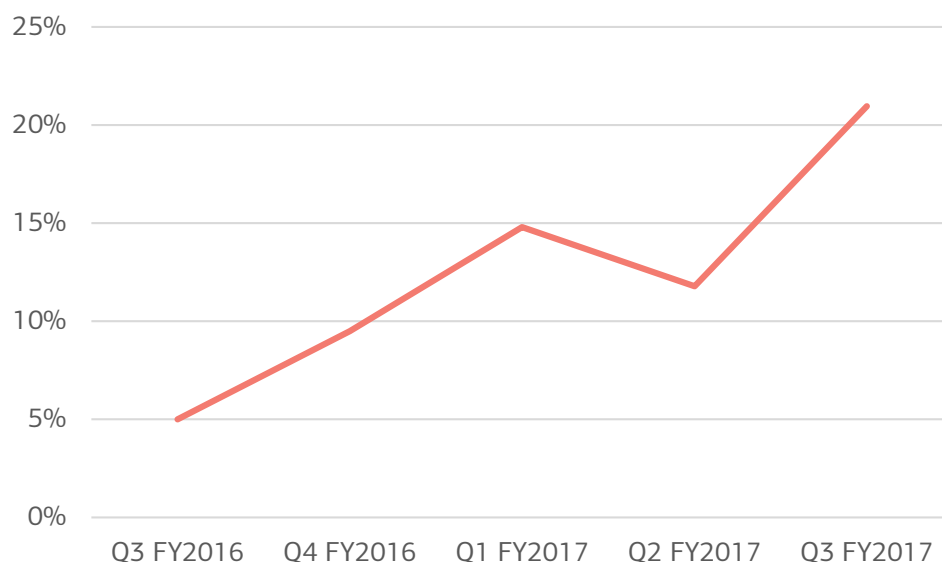
In the Q3 FY 2017 period ending December 31, 2016, JV models contributed 57% of JLR's total sales in China, up from 21% at the end of 2015. The profit contribution from CJLR grew to 21% in Q3 of FY2017 compared with 4.9% in FY2016.

**Chart 3. CJLR as % of Total JLR China Sales**



Source: Company data

**Chart 4. Increasing Profit Contribution from CJLR**



Source: Company data

We estimate that China’s total profit contribution to Tata, including JV vehicles, imported vehicles, and auto parts, will reach 42% in FY 2017, ending March 31.

**Table 2. Profit Contribution from China to JLR**

In GBP million	FY2016	FY2017e	FY2018e
<b>Profit Contribution of CJLR</b>	64	165	222
<b>Profit Contribution of Imports</b>	388	398	402
<b>Total Profits from China</b>	452	563	624
<b>JLR PAT</b>	1,248	1,344	1,395
<b>As % of Total PAT</b>	36.2%	41.9%	44.8%

Source: Company data, J Capital Research Estimate

## CJLR’s Falling Unit Profit

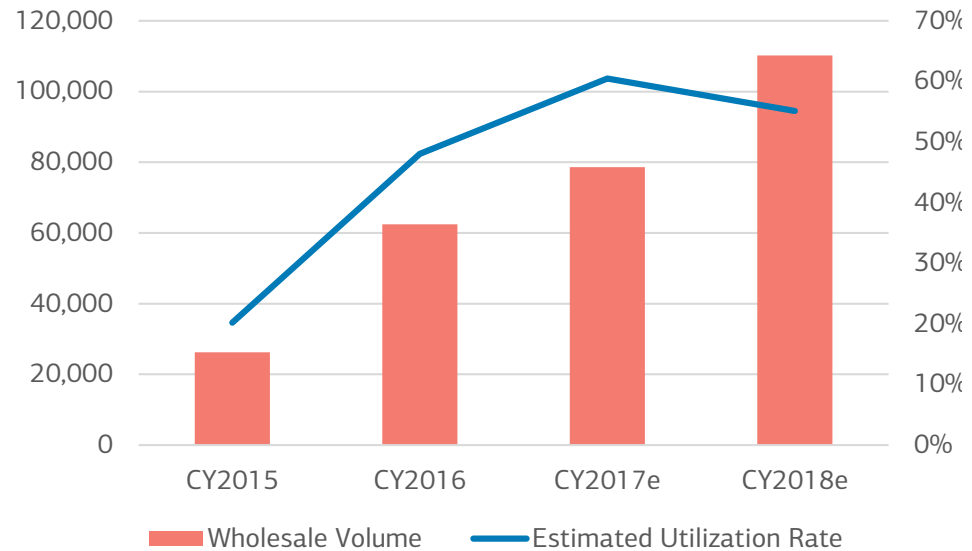
We think CJLR has been excessively aggressive in its investment in China-based production. The JV, with one plant in Changshu, Jiangsu Province, can currently produce 130,000 vehicles annually. Based on CJLR’s wholesale volume in calendar 2016, we estimate that the utilization rate was only 48.1%. Yet the company started Phase 2 in late 2015, adding capacity of 70,000 units. The new facility will go into production in 2018.

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When the F-Pace launches, we estimate utilization will still be only 56% and 50% in 2017 and 2018 respectively.

Assuming that CJLR can maintain sales growth of 16% YoY in 2017 and 37% in 2018, when the F-Pace launches, we estimate utilization will still be only 56% and 50% in 2017 and 2018 respectively.

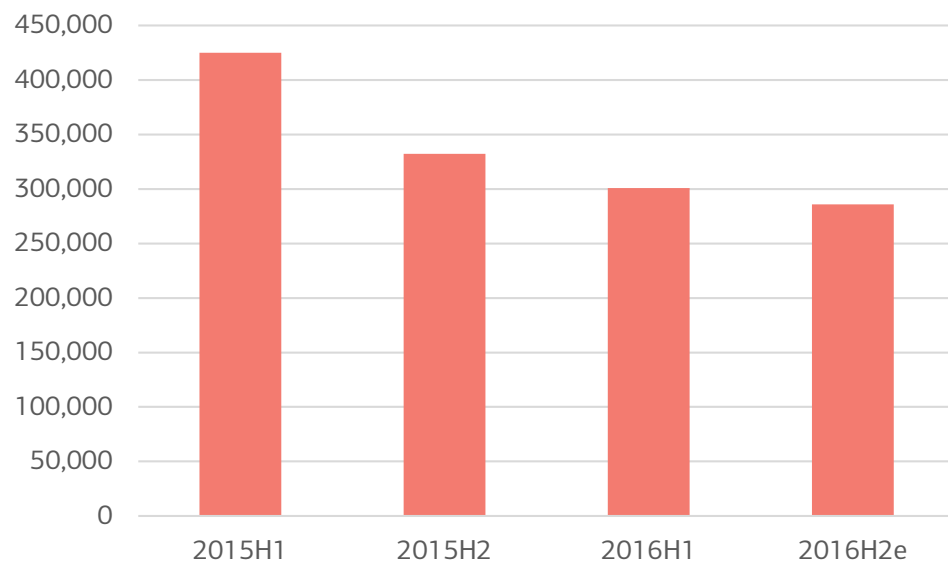
**Chart 5. CJLR's Utilization Rate**



Source: Company data, J Capital estimates

Utilization doubled in calendar 2016, and the XFL launched with a higher selling price than the Discovery Sport. Still, CJLR model prices are declining, as is profit per unit. Profit halved between Q4 FY 2016 and Q3 FY 2017, from GBP 3,910 per unit to GBP 1,640 per unit.

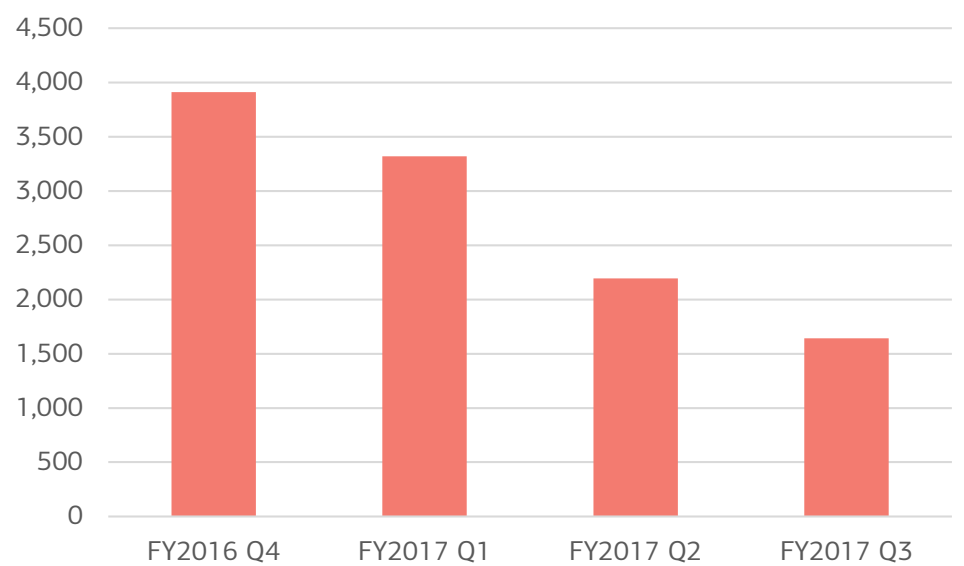
**Chart 6. Falling ASP for CJLR models (RMB/unit, cal years)**



Source: J Capital Estimates and Chery disclosures

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**Chart 7. CJLR's Profit (GBP/unit, fiscal years)**



Source: Company data, J Capital research

**Aggressive Sales Target of over 30% YoY in 2017**

JLR dealers say they have been asked to GENERATE 30% more sales in 2017 by volume, but they say 15% is more realistic. Although JLR will continue to perform well in terms of wholesale volume in H1 thanks to new models, dealers remain conservative on the whole-year sales, and they are gloomy on price.

**Mounting Inventory**

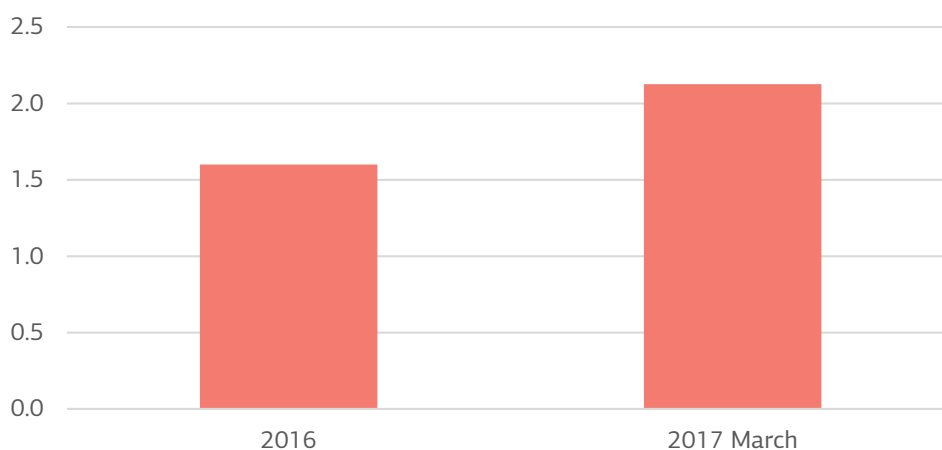
Given that new-vehicle sales are not profitable, dealers rely heavily on the manufacturer's rebate payment for exceeding sales targets. To meet those targets, they are taking more cars than they can sell. Dealers we interviewed are holding an average of 2.1 months of inventory, while a healthy level is about six weeks. Dealers are expecting the situation to get worse in H2.

According to the auto association CADA, industrial inventory has now reached its highest level since February 2014, at 2.25 months. JLR was among the 17 auto brands with inventory above two months. Its reported inventory was 2.19 months at the end of February.

Actual inventory might be even higher in the channel. At present, JLR has 227 official dealers selling both Jaguar and Land Rover. A certain portion of vehicles are sold to tier 2 dealers. Estimates for the portion of vehicles sold through these downstream channels range from 10-30%. This increases the potential for channel stuffing.

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**Chart 8. Average Inventory Level of Dealers**



Source: J Capital research

### Falling Prices

To achieve unrealistic sales targets, we believe dealers will continue to lower prices. We estimate dealers are making roughly a 10% loss per new vehicle sold. To make matters worse, CJLR is rewarding dealers with bonus vehicles, providing more incentive to offer discounts.

**Table 3. Discounts of CJLR Models (RMB thnds, %)**

	ASP per Unit	Current Discount
<b>SUV Models:</b>		
Land Rover Evoque	398.0-578.0	21-26%
Land Rover Discovery	368.0-518.0	14-21%
Audi Q5	400.4-525.3	16%
Mercedes GLC	396.0-579.0	0.70%
BMW X3	421.0-750.0	9%-18%
<b>Sedan Models:</b>		
Jaguar XFL	388.0-688.0	5%-12%
Audi A6L	418.8-746.0	16%
Mercedes New E Class	422.8-629.8	0.70%
BMW 5 Series	435.6-778.6	10%-15%

Source: Company data, Autohome, J Capital research

The Jaguar XFL improved the product mix, but volume is small. For the

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JLR remains far behind the top three luxury brands, Audi, BMW, and Mercedes.

Evoque model, discounts can reach 26%, and even the newly launched 2017 Evoque and Discovery Sport are selling at discounts of over 10%. These discounts are deeper than those for other luxury brands.

### Competition among Top 5 Luxury Brands Will Increase Discounts

As a late entrant to the China market, JLR remains far behind the top three luxury brands, Audi, BMW, and Mercedes.

**Table 4. Top 5 Luxury Brands (Units, %)**

	JLR	BMW	Mercedes	Audi	Cadillac
<b>Total Sales in China in CY2016</b>	119,581	516,355	493,929	591,554	116,406
<b>YoY Growth</b>	29.9%	25.8%	27.8%	3.6%	45.9%
<b>Sales of JV Models</b>	59,293	310,000	317,048	536,289	105,702
<b>As % of Total Sales Volume</b>	50%	60%	64%	91%	91%
<b>Production Capacity of JV</b>	130,000	450,000	420,000	550,000	160,000
<b>Current Utilization Rate</b>	48.1%	68.9%	75.5%	97.5%	66.1%
<b>Models Produced by JV companies</b>	Evoque, Discovery Sport, XFL	1,2,3,5 Series and X1	C, E Class, GLC, GLA	A3, A4, A6, Q3, Q5	CT6, ATS-L, XTS, XT5
<b>No. of Dealers</b>	227	584	523	468	213
<b>Sales per Dealer</b>	527	884	944	1,264	547

Source: Company data, J Capital research

Among Tier 2 brands, the Cadillac is a potential threat to JLR. Cadillac will launch eight new China-made models before the end of 2020, compared with four new models planned by JLR.

**Table 5. Sales Volume of JLR VS Cadillac**

	2015	2016	YoY	2016 1-2	2017 1-2	YoY
<b>JLR</b>	92,474	119,048	28.7%	17,676	21,328	20.7%
<b>Cadillac</b>	79,779	116,406	45.9%	13,103	27,045	106.4%

Source: Company data, J Capital research

### Fat Margins on Imported Vehicles

China remains a gold mine for JLR's imported models. We listed a few



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models of Land Rover, and pricing differentials between China prices and UK prices range from 36% to 133%. That differential is vacuumed up by JLR.

**Table 6. Substantial Profits from Mainland China**

Model	UK price (GBP)	Price (including Chinese tax)	China retail price (GBP)	Premium (GBP)	Premium over the UK price
<b>2017 Discovery</b>	43,495	72,286	95,000	22,714	52%
<b>Range Rover Velar</b>	44,830	74,504	90,476	15,972	36%
<b>Range Rover</b>	63,283	105,173	189,048	83,875	133%
<b>Range Rover Sport</b>	63,283	86,822	110,476	23,654	54%

Source: Company data, Autohome, J Capital research

**Table 7. Higher Prices in China**

ASP (GBP)	FY2012	FY2013	FY2014	FY2015	FY2016
<b>UK</b>	36,557	38,302	39,404	40,476	40,757
<b>North America</b>	34,219	32,905	37,585	39,370	39,906
<b>Europe</b>	33,801	31,900	36,005	35,666	31,549
<b>China</b>	<b>71,321</b>	<b>64,949</b>	<b>64,354</b>	<b>66,740</b>	<b>71,651</b>
<b>All Other Markets</b>	43,226	41,651	42,178	46,560	44,937
<b>Average</b>	42,972	42,422	45,098	46,875	40,817
<b>China premium to average</b>	66%	53%	43%	42%	76%
<b>China premium to UK</b>	95%	70%	63%	65%	76%

Source: Company data

## Parallel Imports Gaining Share

Chinese buyers are aware of the large differential between the price in the China market and overseas, and that awareness has fueled the business of parallel imports.

We estimate that parallel imports of JLR contributed close to 30% of JLR's total sales of imported vehicles or 16.7% of JLR's total sales by unit in mainland China. Those parallel imports are mainly from the U.S., U.K., and

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Europe. These sales count toward unit sales for JLR from other regions but undermine the premium pricing in China. The selling prices of large vehicles are lower in the parallel import market than in official channels.

**Table 8. Parallel Imports as % of Total JLR Imports in China (Units)**

	2015	2016
<b>Parallel Imports</b>	17,309	25,936
<b>Land Rover</b>	12,982	18,526
<b>Jaguar (Estimated)</b>	4,327	7,410
<b>Wholesale Volume of JLR Imports</b>	71,569	60,288
<b>Estimated Parallel Imports as % of Total Imports</b>	19.5%	30.1%

Source: CTCAL, Company data, J Capital estimate

## Valuation

The Street is bullish on Tata Motors, and we think these estimates have to come down. Some 33 analysts rate Tata a buy while 10 have a hold and four sell ratings and yet the 12-month target price is INR 532.78, with only 12.4% upside potential.

The analysts have not factored in a possible economic slowdown in China or the potential negative impact brought about by the restrictions on property transactions in Tier 1 and Tier 2 cities. Also, the reduction of tax breaks, though there is no direct influence on JLR's models, will gradually cool the entire auto market.

We don't have the visibility on TTM's India business or JLR's sales outside of China. Therefore, we use brokers' estimates on Indian business' FY2018e revenue and EBITDA and assume 10% YoY increase in the US in FY2018e and a 10% YoY drop in Europe due to the impact from the UK's exit from the EU. We also expect a decline in parallel imports from Europe due to changes in emission standards in China, bringing down unit sales from Europe but perhaps not supporting price in China, where pricing expectations have declined.

Our target price of INR 406 per share is based on SOTP valuation and

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values JLR at a FY18e PE ratio of 8x (Average of the multiples of BMW & Daimler) and all India business at 9x EV/EBITDA. We value CJLR at a 9x FY19E P/E, the average of Brilliance China and BAIC).

**Table 9. SOTP Valuation of Tata Motors (INR per share)**

<b>JLR</b>	303	8x PE ratio
<b>CJLR</b>	39	9x PE ratio
<b>India</b>	86	9x EV/EBITDA
<b>Total</b>	429	
<b>Holdco Debt</b>	-23	
<b>Total Value</b>	406	

Source: Bloomberg, J Capital Research

## Risks

- ▶ Stronger-than-expected performance of JLR's sales in Mainland China
- ▶ Markets outside of China outperform
- ▶ More government policies in support of auto sales in Mainland China

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