"Tata Motors Q1FY14 Earnings Conference Call"

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MANAGEMENT: **MR. C. RAMAKRISHNAN – CFO, TATA MOTORS LIMITED**

MODERATORS: **MR. ANIKET MHATRE – STANDARD CHARTERED SECURITIES**

Moderator Ladies and gentlemen, good day and welcome to the Tata Motor's Q1FY14 Earnings Conference Call hosted by Standard Chartered Securities. As a reminder for the duration of this conference call, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference please signal an operator by pressing * and then 0 on your touchtone phone. Please note that this conference is being recorded. I would now like to hand the conference over to Mr. Aniket Mhatre from Standard Chartered Securities. Thank you and over to you sir.

Aniket Mhatre Thank you Mohsin. Good evening everyone. Welcome to the post results of conference call of Tata Motors. To discuss the results today we have with us Mr. C Ramakrishnan the CFO of Tata Motors and the investor relations team. I would now request Mr. Ramakrishnan to begin with his initial remarks on the results and then we can begin the question and answer session. Over to you sir.

C Ramakrishnan Thank you Aniket. Good morning to all of you. Sorry for the delay in starting the call as we were coming for the call from different places. We were stuck in different parts. My apologies for the delay. I am going to make the opening remarks very-very brief and may be leave more time for the Q&A to follow. We announced a shorter while ago the first quarter April to June results for financial year 2013-14. On a consolidated basis Tata motors net revenue stood at Rs. 46,785 crores up from Rs. 43,324 crores in the same quarter last year. On a consolidated basis EBITDA margin came in at 14.4, same level as last year and profit after tax of Rs. 1726 crores. Good part of the performance and the results at the consolidated level was driven by one more strong financial performance and results by Jaguar Land Rover. Tata Motors standalone the net revenue was down at Rs. 9105 crores compared to Rs. 10,586 crores in the same period last year. EBITDA margin further dipped to 2.3% compared to 7.3% a year ago. Profit after tax came in for this quarter at Rs. 703 crores but that is after considering dividend from subsidiaries particularly Jaguar Land Rover of over Rs. 1500 crores. Weak macroeconomic environment in India affecting the overall demand for both CV and PV businesses, competitive pressures and lower net realization affected our margins and performance significantly in this quarter. Jaguar Land Rover under IRFS accounting, the net revenue was over £4 billion up from £3.6 billion same quarter last year. EBITDA margin came in strong at 16.5 for this quarter compared to 14.5 a year ago. And profit after tax was £304 million compared to 236 last year first quarter. Higher volumes in Jaguar Land Rover, richer product mix and favorable exchange rate resulted in very strong both operating performance and financial margins.

Overall at a consolidated level **our net automotive** debt to equity stood at 0.31. Tata Motors was higher at 0.81 and Jaguar Land Rover net debt was negative because of strong cash & cash equivalents in the balance sheet. We continue to invest in both the businesses . capital expenditure and product development. In the India business, we had given guidance of about Rs. 3000 crores on an average annually that continues to hold, will continue to invest in our newer products, variants both in commercial vehicles and passenger vehicles. In passenger vehicles numbers of actions have been initiated for enriching the product profile going forward. We launched Horizonext branded program in Tata Motors for improving the product presence in the marketplace, better customer experience, manufacturing processes and after sales service. In Jaguar Land Rover again we had given indication of £2.75 billion annually in terms of product development & capex that will continue to focus on newer product introductions and capacity increase. The newer products we introduced last year, the new Range Rover, Jaguar XF Sportbrake, Jaguar F-Type going well, well received in the market and Range Rover Sport will be launched shortly. I will stop here and may be give more time for question and answers and throw the line open for questions now.

Moderator Thank you very much sir. We will now begin the question and answer session. The first question is from the line of Yashesh Mukhi from Morgan Stanley. Please go ahead.

Binay This is Binay from Morgan Stanley. I had two questions on JLR, firstly there has been a lot of news flow on inventory piling up in China. Could you throw some light on that? Continuing with the same, how are you seeing the discount trends in Jaguar portfolio specifically across regions, how do you see the reception of the new Jaguar across regions? And lastly, we do note that Free Cah Flow profile of JLR has slightly slipped on a quarter on quarter basis. Could you throw some light as to what drove that?

C Ramakrishnan The first question was on the inventories and pile up in China as you called it, we have not seen that trend in our business. This is not a correct statement as far as JLR is concerned. Many of our product line continue to be on a pull mode overall and in China also. Without referring specifically to the discounts that you mentioned in the second question, I would say if you take – I am not committing particularly with specific reference to the quarter but in general in the last year-year and a half I think the variable marketing expenses in total have been going up but we have not seen any alarming or significant increase there or bloating there in any other markets. But generally the trend has been on the increase since the low levels we saw about six quarters ago. Lastly your last question was on free cash flow, was it?

Binay Yeah.

C Ramakrishnan Jaguar Land Rover as I said yearly is spending and investing a lot in the product development and capital expenditure. The free cash outflow for Q1 FY14 was £341 million after CAPEX and product development spend of £558 million and negative working capital movements.

Binay I do not have the data but how has the working capital been for JLR in Q1?

C Ramakrishnan The working capital is difficult to comment on quarter to quarter basis, but in the first quarter you will generally see an increase in the working capital requirements. That is no different in this year.

Binay So it is more to do with the seasonality rather than anything else?

C Ramakrishnan That is right.

Moderator The next question is from the line of Kapil Singh from Nomura Securities. Please go ahead.

Kapil Singh Just wanted to check a couple of things. Firstly on the raw material cost for Tata Motors standalone we have seen a decline in raw material cost to sales, so just wanted to understand is it related to a lower discounting or is it because of a genuine decline in RM costs that you have seen?

C Ramakrishnan It is surely not **lower discounting**, that will be an incorrect statement. The discount levels and overall net realizations have been relatively weak and have continued to remain relatively weak compared to **what** we have seen in the past, while we are moderating our variable marketing support and also making the price increase here and there. Overall the market trend has been quite severe in this regard. The raw material turnover ratio, while it is difficult to give the breakup on an each quarter basis, in general I think it has been contributed more by a combination of model mix as s richer model mix can result in an overall lower percentage and also the second factor that you mentioned, we have seen relative steadiness in the commodity prices and we have also been undertaking significant cost reduction programs in the business,.

Kapil Singh Sir, does the weakness in rupee put a pressure on cost going forward or you see raw material cost holding at these levels?

C Ramakrishnan I think we should relatively be okay on the rupee front on our business, our exports tend to be generally higher than our import. The import **content** in vehicle per se is relatively less but there may be some consequential impact that we may see particularly if the material prices shoot up , but we have not seen that phenomenon in this quarter.

Kapil Singh And so secondly just on the inventory levels specially for heavy trucks for both Tata Motors and the industry if you have any thoughts, where are we and have we done any further inventory reduction even in the first quarter or the retails and wholesales were largely in line?

C Ramakrishnan Generally partly on account of seasonality etc towards 31st March the inventory level in the pipeline as well as the company tends to be at a low point and it starts building up in the first quarter and second quarter for the busier period in the later part of the year. Since you asked specifically about commercial vehicles our inventories are very much under control, whether it is with the company or with the dealers, the inventories will, I would say be on the lower end of the range that we normally operate between 20 and 30 days. **Kapil Singh** This is for the company and dealers put together?

C Ramakrishnan Yes, I am talking about inventories being in control in the total chain.

Kapil Singh So that is about 30 days with the dealers or with the company and dealers put together?

C Ramakrishnan I would think it can vary from product line to product line. It will be between 3 to 4 weeks for the dealers but at the company it will be much smaller.

Kapil Singh Okay sir that is helpful. And for the industry as a whole do we see higher levels or they would be around similar levels?

C Ramakrishnan I think we would be operating at a relatively at the lower end in terms of the industry phenomenon.

Moderator The next question is from the line of Sonal Gupta from UBS Securities. Please go ahead.

Sonal Gupta Just to start with, one I just wanted to get a sense of on the India passenger vehicle side given that we continue to see a very sharp decline on a year on year basis in terms of volume. So I mean in terms of your action plan I just want to get a sense in quality terms, did you see the losses in this business sort of continuing to widen or do you think your action plan, your losses in this business have peaked and you should see an deceleration in losses from here. I mean any sort of qualitative sense that you can give on this business?

C Ramakrishnan Actually we have discussed about it in the past on different occasions, both in calls or interactions like this as well as in many other interactions with the business leadership. We are launching a number of actions within the passenger vehicle business. First there is off course a factor of the market being very competitive. The overall volumes being down for everybody and the pressure on pricing, that is a general phenomenon but more than a general phenomenon I think in many areas we also need to step up our actions what we are focusing on. I talked about a number of model launches recently, it was in June. Almost 8 variants and newer models across the product range, something which one has not seen in this country before. We need to work much better on our manufacturing process. We are also focusing on the sales effectiveness and the customer experience while buying a vehicle as well as **overall** sales experience. A number of initiatives have been launched, **it is a little while** it is taken off well and there is a momentum and there is a commitment to make it work and emerge successfully. It is early days, i may not have the statistics to share with you at this stage. I think it will take a couple of quarters for results to show. As far as the financial performance is concerned it is a very competitive market and in terms of our overall volumes we are operating at relatively lower levels of capacity utilization but we hope with the actions that we are launching, not only in terms of sales and commercial area but also in terms of cost control and cost rationalization. I think in one of the calls I mentioned earlier within the company the focus on material cost and managing of a supply chain and materials has become much-much sharper. The constitution of integrated centralized purchasing function between our commercial vehicles and passenger businesses hope to draw a lot of synergy and there are a number of other actions. So I think we need to focus both on the cost side, on the product side, on our manufacturing processes as well as in the commercial areas.

Sonal Gupta Okay. And sir my second question is on the JLR side we have seen an improvement in terms of the average selling price on a quarter on quarter basis, so would it be possible for you to segregate this into currency versus product mix effect? And the other thing was if you could just give us like you gave for the MHCVs inventory number, would you have a similar number for inventories in China for JLR?

C Ramakrishnan on the inventories, number of days in China, I do not think I will be able to give a specific comment in terms of market inventories at different regions. So I would tend to think, yeah but there is no different in China compared to other markets. In general the inventories overall would be between 30 to 45 days in JLR for different markets. Some of the ouer markets away from the home base will be slightly longer in terms of lead time and reaching out. So I would tend to think we will be operating within this band. It may vary from product line to product line but generally in that range.

Sonal Gupta And sir on the ASP, is it possible for you to give -

C Ramakrishnan It is difficult to segregate it exactly the way you have put because it is a function of exchange, it is function of model mix, it is function of regional mix, after al lJLR sells in hundred plus countries with round about 20% coming from each of the regions China, Europe, UK, US etc. So it will be difficult to segregate that but yes the effect is a combination of all those.

Moderator The next question is from the line of Jamshed Dadaboy from CitiGroup. Please go ahead.

Jamshed Dadaboy We have been noticing that Evoque volumes have been flat-lining while Freelander volumes are up about 7% on a YoY basis. Can you explain the difference in the market dynamics in these two product lines?

C Ramakrishnan It is partly the capacity management also as they share common production lines. It may vary from quarter to quarter but it is partly an effect of rationalizing capacities in different quarters between different product lines.

Jamshed Dadaboy Has the new Range Rover being rolled out across all markets?

C Ramakrishnan Yes, you are not talking about the Range Rover Sport, you are talking about the new Range Rover?

Jamshed Dadaboy Yes.

C Ramakrishnan Yeah.

Moderator The next question is from the line of Govind Chillapa from Jeffries. Please go ahead.

Govind Chillapa I have three questions. One, we noticed that in the domestic business your EBITDA is barely able to cover the interest cost, in fact it is lower than the interest outgo every quarter. And this has been the case for the last four quarters. Now given that you are continuing to invest in CAPEX, Rs. 3000 crores a year that you have spoken about and the gross debt is about 18,000 crores. At what point do you take a call on whether you need to do an equity issuance or not? That is #1. Second, the Ace segment which was holding up very well till last quarter that also seems to have slowed down now. What is your view on that segment? That is the segment that we have been quite positive on for a while and this is probably the first time we are seeing a slowdown in that segment, so if you could just talk about what is happening in that market.

And lastly, would it be possible to quantify the indirect import content like other companies like Maruti and Hero have spoken about 9% to 13% of indirect imports that is coming through their vendors. Would you have a number similar to that for yourself?

C Ramakrishnan May be I will respond to the questions in the reverse order. I do not have a ready number in terms of the indirect import percentage content. I would tend to think it will be in single digits between 5% and 10%. This does not include some of the consequential impact you may see on exchange front. What I mean is with rupee-dollar parity sometimes you also get some overtime, in fact on the steel prices which are normally linked to the international prices, excluding that in terms of indirect import content, import by our vendors I would tend to think it will be in single digits between 5% and 10%. Second question you had was on Ace segment. Yes, it is true that segment had softened in this quarter which is a phenomenon we had not seen in the earlier period. It is also partly to do with some tentativeness on the part of the financing lending agencies, banks and NBFCs that we have seen in terms of willingness to lend to first time users to this particular category of borrowers. It may be a reflection of the overall sentiment in the market perhaps. Well I hope it will get corrected over time. I think the underlying potential for the product continues to have a positive movement, I mean people do want to buy it but I think this will undergo some adjustment as we go along. But it is true that we are seeing some softness in that overall segment mainly contributed by some tentativeness on the financing side. First question which was on what point of time would you decide on equity, obviously not in a position to answer that one way or the other, even in the India business while you talked about overall debt numbers and interest. Our net debt-equity ratio continues to be relatively okay **while** it is higher than the range which I had mentioned between 0.5 to 0.75, we are right now at 0.81. It is also a reflection of the current market dynamics that we have seen and hopefully with the improved financial performance, some of this will get corrected. Beyond that I will not be able to give a specific answer to that question.

Govind Chillapa So that is the difficulty that we are facing. I mean you have a very good consolidated balance sheet. Even the standalone balance sheet is not very stretched but just from a cash flow perspective that for the last 3-4 quarters that the cash flows are not really great. So I was just trying to figure out what would the decision be based on. I am not asking for a timing or anything, what would be the decision be based on? If you take a call today that for the next one year the market remains weak, would you then start thinking about equity issuance or are there other alternatives that you have in terms of sell down of any assets that you have or there is a constant speculation about listing JLR. So are all these under consideration?

C Ramakrishnan Whatever is under consideration obviously you would not expect me to give you an outline of our fundraising plans at this point of time. We will definitely take into account the market situation, the trade cycles and the current trend we see in the marketplace. It will be a balanced decision taken by the board at the appropriate time. I cannot give an advanced indication on this at this point of time.

Moderator The next question is from the line of Sanjay Doshi from Reliance Mutual Fund. Please go ahead.

Sanjay Doshi Just one question from my side, we have made a charge on the reserve side for the pension liabilities in this quarter, can you please update us on what is the gap and what contributions are required annually for that?

C Ramakrishnan Accounting and the results for this quarter is more of the IFRS accounting treatment in terms of the accrual assumptions for the pension funds. I think your question is more on the overall budget pension deficit as agreed to the trustees and the cash contribution annually. I would think the cash contribution ranges between £50 to £75 million over 7 or 8 year period but in that range.

Sanjay Doshi Okay, so it is closer to that £75 million a year?

C Ramakrishnan Yeah.

Sanjay Doshi So the gap has not widened from the last analysis that we would have done. Is that the case?

C Ramakrishnan I do not know what you mean by last analysis. I think the last agreement of the trustees was almost three years ago but it has widened since then. All the underlying actuarial assumptions have caused the widening. It has widened. As I recall the numbers I think it has widened from 400 to about 600, the overall deficit.

Sanjay Doshi And when is the next due sir with the labor unions, I mean the talks for any further changes in contribution?

C Ramakrishnan No, it is not with the labor union, it is with the pension trustees. But you are talking about the pension, right?

Sanjay Doshi Yes.

C Ramakrishnan Pension trustees, could be another three years from now.

Moderator The next question is from the line of Yogesh Agarwal from HSBC Securities. Please go ahead.

Yogesh Agarwal Going back to the cash flows for the quarter, you said it is a seasonal increase but can you just provide a little more color on that because in the past few years we have seen an increase but this time it is quite severe and secondly even the retail phase have been better versus wholesales this quarter so what are the seasonal factors there and then just related to that from a full year basis do you still expect the operating cash flows to fund the entire CAPEX?

C Ramakrishnan Our objective has been to see that a year operating cash flow generation is able to meet the product development capital expenditure. Since we have stepped up the CAPEX this year significantly from range of around £2 billion to about £2.75 billion we have also built up sufficient cash resources in the company. As I said earlier JLR today has cash in the balance sheet, cash and liquid fund investments are well over £2 billion. In addition we have also increased the committed lines of credit between 3 to 5 years, which was earlier at about £800

million it has increased to about £1.25 billion. This facility is completely undrawn as of today. So really speaking in terms of access to funds, own funds and cash of about £2.2 billion plus drawable credit lines of about £1.25 billion. That is the liquidity that JLR is sitting on right now. So if there is a marginal shortfall between operating cash flow generation and capex and product development spend, I am sure the company will be able to comfortably meet with that without an issue.

Yogesh Agarwal And anything on the quarterly phenomenon?

C Ramakrishnan As I said earlier, the fourth and second quarters of a year for JLR tend to be relatively stronger and you would see inventory bottoming out at the end of the quarter that is 31^{st} March or 30^{th} September and then we had ramped up. And in the second quarter you also ramped up to make up for the shut down in August in terms of production and for new product launches that you start building inventories particularly the Range Rover Sport in this particular year. So you would see all this phenomenon happening in that quarter. It is nothing unseasonal or exceptional. It is as per plan.

Moderator The next question is from the line of Akshay Saxena from Credit Suisse. Please go ahead.

Jatin This is Jatin. My question is on your JLR margin guidance, you have been guiding for a margin of between 14% to 15%. But what has traditionally been a weak quarter, once we have margins of more than 16% and from hereon we would see the new Range Rover Sport coming in as well as volumes pick up. So are you thinking about revising your margin guidance?

C Ramakrishnan It has been a good quarter. There have been earlier quarters where we had actual margins over 16%, but as you said they have been not in the first quarter but in different parts of the year. Yes, it has been a very good and a satisfying and good performance. It is exactly a 200bps improvement in margin compared to the same Q1 of last year. Partly contributed by the growing China volumes, a superior product mix as well as the currency been in our favor. I don't want to comment upon the guidance.

Jatin And in your business review we see that the inventory in JLR at your end has increased. So is that a function of you having produced some Range Rover Sport and hence that is getting reflected there?

C Ramakrishnan Yeah, quite right.

Moderator The next question from the line of Martin Moorman from Pimco. Please go ahead.

Martin Moorman I have two questions. One just going back to the pension deficits, I did not catch what the latest deficit number was. I think you mentioned it was 390 million previously and it increased to a new level.

C Ramakrishnan Round it off, it was around 400 earlier and it has gone up to 600 now.

Martin Moorman And what annual contribution will that involve?

C Ramakrishnan In terms of annual contribution for the deficit it will be between £50 to 75 million for the next 7 or 8 years.

Martin Moorman And my second question was you capitalized a large percentage of your product development cost at JLR. I think it is around 80% which is sort of far higher than the norm in the industry. Can you just explain why you used that accounting treatment and whether that will continue at that level going forward?

C Ramakrishnan There is no intention to change the accounting treatment, which is in line with the IFRS guidance and principles and accounting **GAAP**. I have tried to explain this in many of the earlier interactions. JLR is practically new business starting from 2008 when we acquired the company, all the product development and whatever technologies they had have been paid for as a part of the acquisition and the business started spending on fresh capex and product development from 2008 onwards under our group. As it happens JLR also has substantially increased its investment and is much more focused on – I would tend to think the JLR investments in newer products, variants, etc., is much more accelerated now than ever before. I think that is another phenomenon that is happening here. There is no intention to change this accounting treatment but over a period of time, over the next 3-5 years, I think this percentage will tend to gradually fall.

Moderator The next question is from the line Pramod Kumar from IDFC. Please go ahead.

Pramod Kumar My first question pertains to the depreciation number in JLR. I think even with new products coming on stream we have seen the depreciation number coming down in absolute terms on a sequential basis of course, so just want to understand how should one treat or look at depreciation for the rest of the year? Is it like fair to assume that it should see a sharp improvement going forward or is it the kind of levels one should expect?

C Ramakrishnan In general I would say over next 3-5 years as the products get introduced and the amortization, depreciation meter starts from the newer introductions, the depreciation amortization line will tend to increase sharply in JLR. For the particular quarter in question if you want I can send some clarifications separately to you. But directionally yes, it will tend to increase rather sharply.

Pramod Kumar And sir how should one look at the consolidated free cash flow because as you said JLR you aim to have an operating cash flow which can match CAPEX and then there is a dividend payout as well to the parent entity and standalone I think you are not changing your CAPEX guidance of 3000 crores for the next 2-3 years. So how should one look at, as in the consolidated cash flow for the company and whether the shortfall will be more funded through debt in the near term or is there an equity issue in the near term possible?

C Ramakrishnan I think the free cash flow even at a consolidated level will tend to have some gap over the next couple of years. A lot would depend on the turnaround in the India business and how the business here starts generating positive cash flow. So I am trying to make a prediction on this. We will look at opportunities for funding this gap. In response to one of the earlier calls we had some comments about selling some of the investments or raising debt or I think it is a combination one has to look at from time to time depending on the prolonged nature of the current cycle that we are going through but no specific plan at this time.

Pramod Kumar And sir final question on capitalization as in capitalization has seen some sharp improvement as in **I think** which you are guiding for. But how should the trend continue going forward because you have already have a F-Type coming into the market. Probably Range Rover Sport will be going into the next quarter. So is it like end of first half, is that more like a stable level for capitalization or it will continue to be going up in line with the CAPEX guidance?

C Ramakrishnan I presume by capitalization you mean capitalization part of the product development

Pramod Kumar Yeah, that part which goes through the other expenditure line, and not the EBITDA level.

C Ramakrishnan We need to remember JLR also has been on a significantly upward curve in terms of the annual spend. Three years ago the annual spend was about £1-1.5 billion. 2 years ago the spend was about £2 billion or may be 3-4 years ago it has even lowered than that. As we go through this type of steep increase in the product development outlay, the total spends starts increasing much sharply, £1 billion to 1.50, 1.50 to 2 billion, 2 billion to 2.75 billion. As new investment is increasing at such a sharp rate the percentage will always look very odd because the new expenditure which is on product development tends to get capitalized and you do not see much of an impact because the base is increasing quite sharply. As the annual development stabilizes let us say around £2.5 or 3 billion and the stability reaches in terms of what we are spending, the percentage will look slightly different.

Pramod Kumar So is it fair to look at the margin ex of capitalization so that is going to be much more stable vis-à-vis because the capitalization rate will as a percentage of revenue would be much more higher in a quarter like this. So is it fair to look at margins or track margins ex of capitalization basis?

C Ramakrishnan I would not know what it is fair for you to look at. One of the questions earlier was in compared to benchmarks in the industry your capitalization is much higher. It is a phenomenon of the growth curve that we are going through. In three years time we have almost doubled our capital expenditure spend from £1.5 to 3 billion, close to £3 billion. So hopefully one way is to look at it as an expenditure, the other way is to look at it as an enrichment of the product and hopefully it will result in better top line and bottom line going forward, better volumes on what you are looking at.

Pramod Kumar No sir, my question pertained to move from the perspective that the margin would be reporting ex of capitalization so for example capitalization this quarter is 5.9% of revenue versus 3.9%

in March quarter. So that is a 200 bps addition. So we are trying to move from that perspective because that affects the margin in a big way.

C Ramakrishnan Yes, it does. I have no dispute with that. But I cannot tell you because it depends on the purpose for which you are looking at. If you are doing a comparison with industry you could look at general levels of capitalization which tends to range between around 40-50% for the industry. You could do it that way also instead of removing the entire thing.

Moderator Thank you. Ladies and gentlemen due to time constraints no further questions can be taken. I would now like to hand floor back to Mr. Aniket Mhatre. Over to you.

Aniket Mhatre Thank you Mohsin. On behalf of Standard Chartered Securities I would like to thank the management team of Tata Motors for giving us an opportunity to host the call. Thank you very much sir. Thank you to all the participants for being there on the call. Thank you and have a nice day.

C Ramakrishnan Thank you.

Moderator Thank you. On behalf of Standard Chartered Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.