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India – Lessons from the Tata Group

Discussion Material

2016

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Overview of India

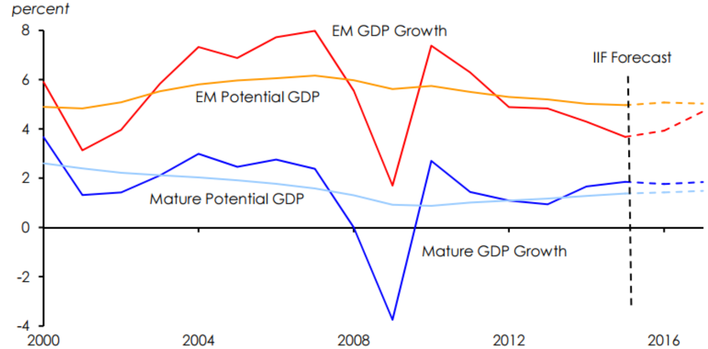
The Tata Experience

Emerging Markets Continue to Provide Promise

Economic Considerations

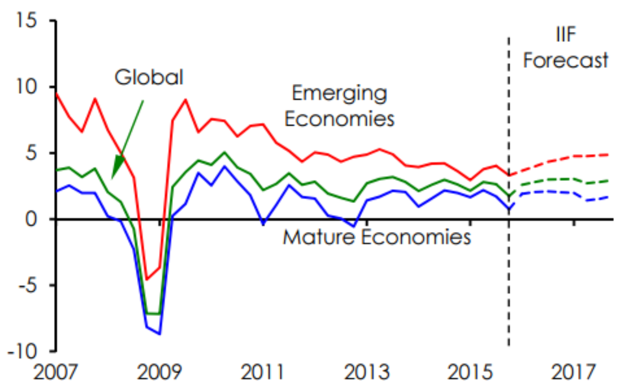
- Concerns about emerging markets over the past year do not reflect the economic reality in India – much of the unsettling results have come from China's stumbling growth or troubles in Russian and Brazil, who have seen political uncertainty and have been affected negatively by the rout in commodities.
- By contrast, the commodities glut has been a boon for Indian industry, and India may indeed act as a ready alternative for those seeking to move EM investments from other BRICS.
- This being said, the full force of PM Modi's promises have yet to be seen, which may either cause improved results or cause investors and markets to reconsider their current optimism.

Chart 1
GDP Growth vs. Potential GDP
percent



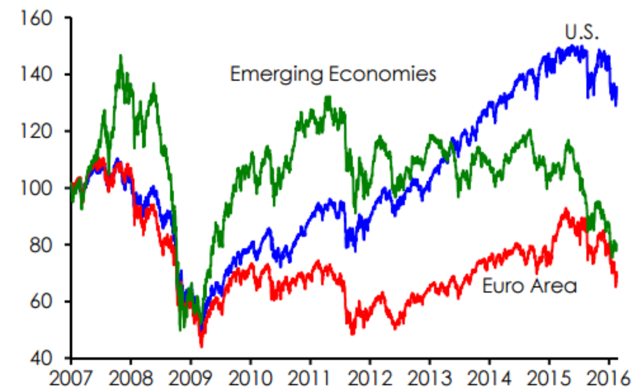
Source: World Bank (Potential), IIF (Actual).

Chart 21
Real GDP Growth
percent change, q/q, saar; forecasts through 2017Q4



Source: IIF.

Chart 27
Equity Markets
index, Jan. 2007=100; last observation: Feb. 16, 2016



Source: Bloomberg, IIF.

Overview

Key Economic Considerations

- GDP in 2016 (est.):
    - USD 2.384 trillion (Nominal)
    - USD 8.727 trillion (PPP)
- GDP growth year-over-year for 2015-16: 7.6% (est.)
- Currency: Indian Rupee (1 USD = approx. 68 INR)
- 2015 estimated GDP Per Capita: $1,820 (nom.) / $6,664 (PPP)
- November 2015 inflation: 5.41 %
- Labor force: 502.3 million (2014 est.)
- Unemployment: Approx. 2.2% (2014)
- Total exports: $477.1 billion
    - Major partners: EU, US, UAE, China, Hong Kong
    - Major goods: Software, petrochemicals, varied.
- Total imports: $609.9 billion
    - Major partners: China, EU, Saudi Arabia, UAE, Switzerland
    - Major goods: Crude oil, gold and precious stones, electronics , coal and ores.
- Ease of doing business ranking: 130^{nd} of 189 (2016).

Key Statistics

- Population: 1,276,267,000 (2015 Estimate)
- Area: 3,287,590 sq. km. / 1,269,346 sq. mi.
- Capital: New Delhi (Pop.: c. 250,000; Metro pop.: c. 22 million)
- Largest City: Mumbai (Pop.: 12,442,373)
- Government: Federal parliamentary republic

Economic & Political Considerations

Economic Considerations

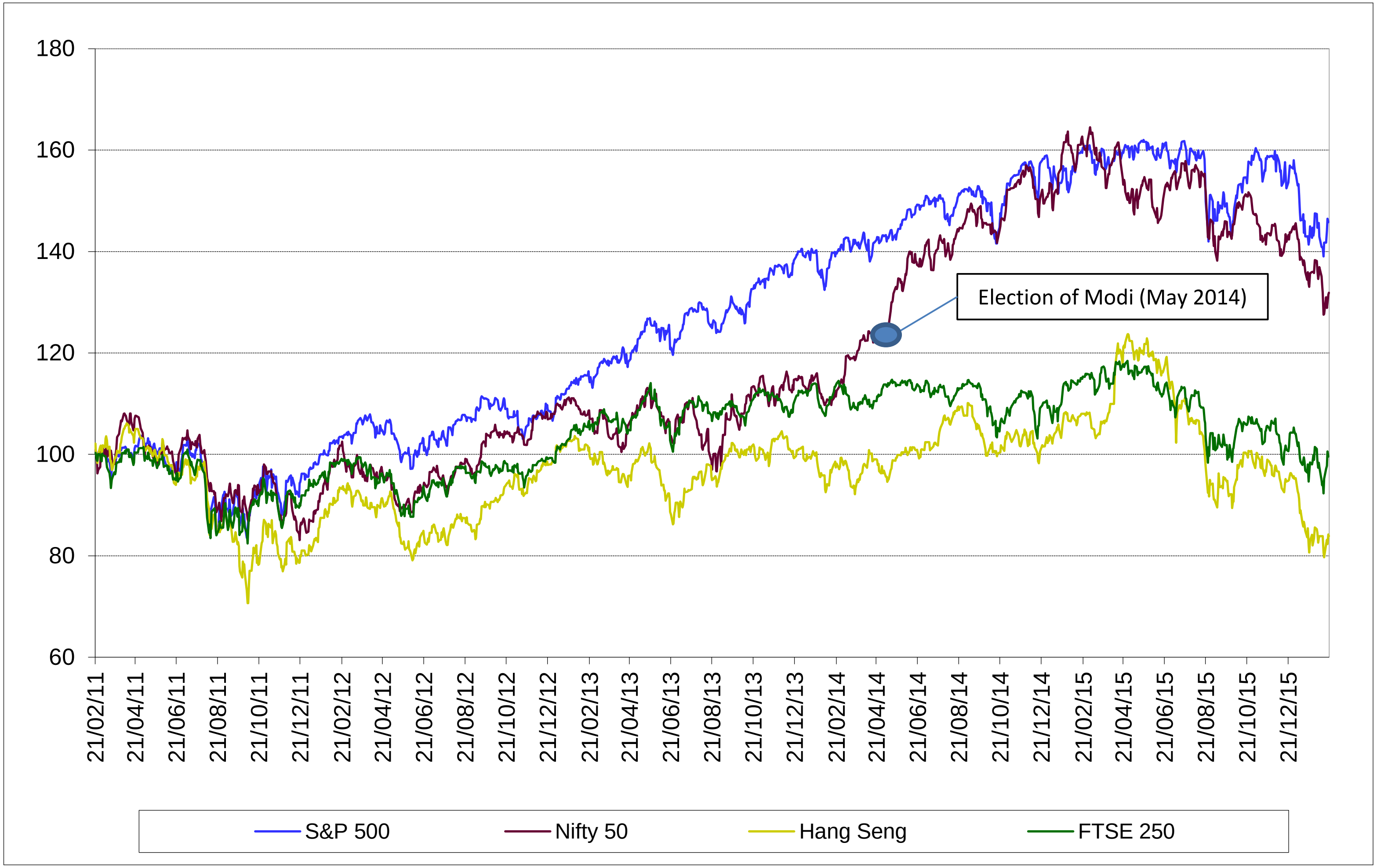
- In the wake of lowered growth expectations in China, India is increasingly looking like an attractive alternative market for both FDI and other diversified investment.
- Access to a predominantly English-speaking population (among those with higher education) as well as continuing population growth will yield a demographic dividend as other peer nations (e.g., China) begin to age.
- Decreasing commodities prices, especially crude oil, will continue to beget positive economic opportunities for India, a net importer of raw materials and commodities.
- Moody's sees India enjoying GDP growth in the range of 7.5-7.6% through the end of 2017, determining the Indian economy to be "well insulated" from external shocks.
- Areas of strength continue to be IT, software development, and other service sectors – it remains yet to be seen increasing costs and expected decreases in regulation will yield a move of manufacturing to India.
- The country could see doubly positive effects in the near future due to an emphasis on the construction of physical infrastructure – it will boost GDP through spending as well as make India a more attractive destination for investors, both foreign and domestic.

Role of Sanctions

- The 2014 election of Nahendra Modi of the Bharatiya Janata Party (BJP) – a change from the historically dominant Congress party – was heralded by the business world as an opportunity for increased economic growth.
- Despite dashed expectations early in his term, it would seem that economic growth is now increasing sustainably, with the highest levels seen since before the 2008 financial crisis.
- The new administration has started the "Make in India" campaign, which will incentivize FDI in India in 25 sectors of the economy.
    - Sectors available for 100% FDI (avoiding the need of an Indian partner) include automobiles and automobile components, chemicals, aviation, railways, oil & gas, and biotechnology; among others.
- In October 2015, FDI was up 61% as compared to 2014.
- Rapprochement with China may lead to economic synergies between the two countries, though Modi's nationalistic rhetoric and expansion of defense forces may complicate this.
- The new leadership has shown an intense interest in developing the technology industry, which could be a key point of growth due to India's extant capabilities in the IT sector.

Performance of India Equity Markets: is the Modi effect gone?

Nifty 50 (Indian Benchmark) vs. Global Benchmarks



Performance of Indian Rupee: a constant devaluation?

From 45 to 68 Rupees to the dollar

INR | USD

Year	2014-15 (US $ billion)	2013-14 (US $ billion)	% change
Total revenue	108.78	103.27	5.3
Sales	106.85	102.02	4.7
Total assets	117.9	116.3	1.4
International revenues	73.41	69.4	5.8
Net forex earnings	6.7	5.3	25.3

- Financial year is April-March
- Exchange rate: USD=Rs61.15 for 2014-15 and USD=Rs60.50 for 2013-14
- Revenue figures for group companies are consolidated and net of excise duty (wherever applicable)

Group's capital market performance

Shares of the Tata group companies have been among the star performers on the Indian stock market over the last three years. Trends in the group's total market capitalisation along with aggregate market capitalisation of Bombay Stock Exchange are provided below.

	2013 (Rs crore) (End March)	2014 (Rs crore) (End March)	2015 (Rs crore) (End March)	As on Feb 18, 2016 (Rs crore)
Tata group	518,716 ($95.56bn)	684,859 ($114.35bn)	832,374 ($134.0bn)	692,079 ($101.10bn)
BSE	6,416,268 ($1,182bn)	7,521,057 ($1,256bn)	1,01,49,290 ($1,621bn)	8,839,477 ($1,291bn)

- With the listing of TCS on August 25, 2004, the total market capitalisation of the group's 29 listed companies crossed the Rs100,000 crore mark and the group acquired the distinction of having the highest market capitalisation among all business houses in the country, both in the public and private sectors.
- Tata group accounts for 7.8 percent of the total market capitalisation of BSE.
- Tata companies enjoy the trust of over 3.9 million investors.
- Figures within the bracket are in US $ billion.

Total number of employees

600,000

Performance of Indian Rupee: a constant devaluation?

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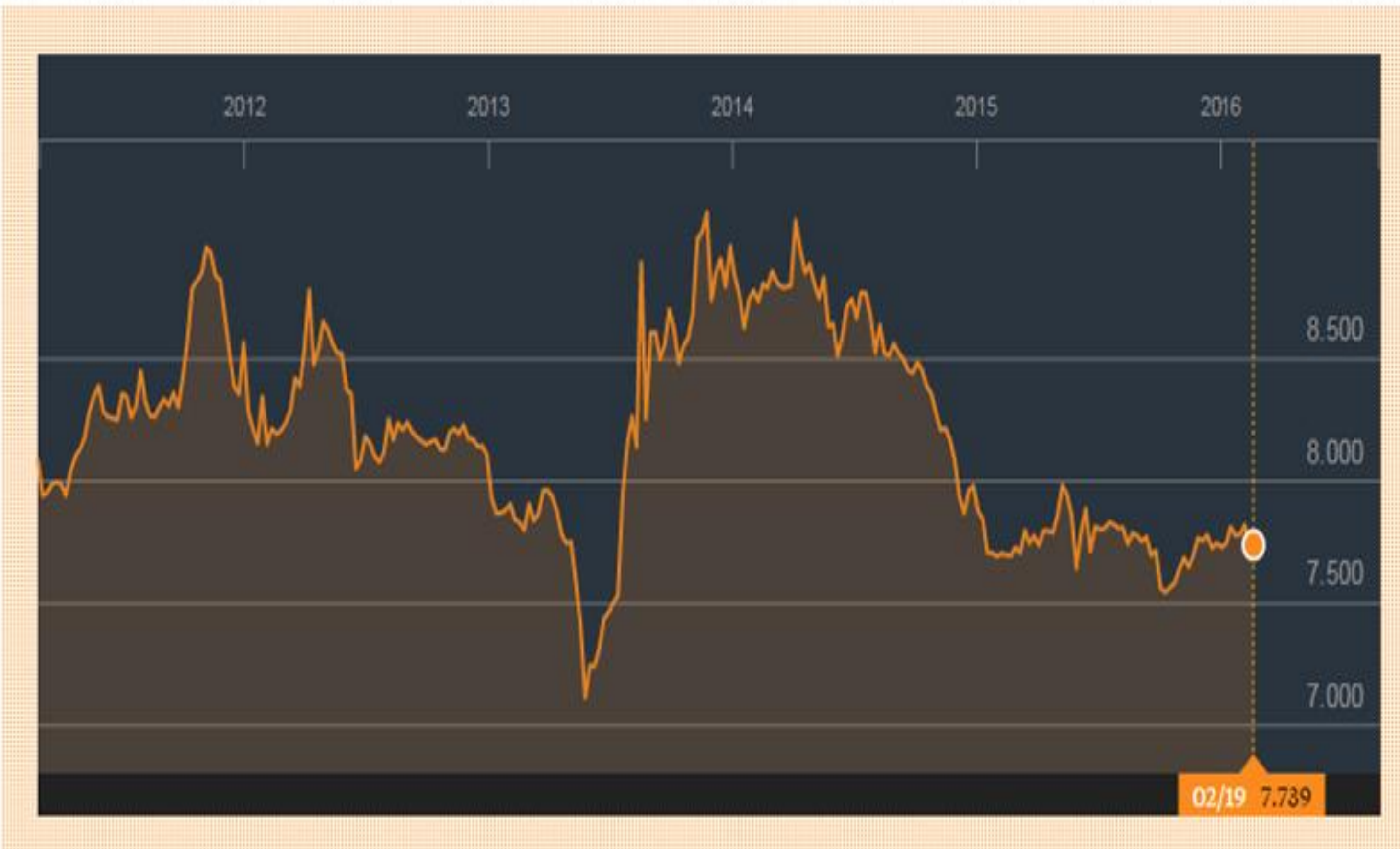
Indian interest rates: the temptation to borrow in dollars

A lenient interest rates policy explains the weakness of the Rupee



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Overview of India

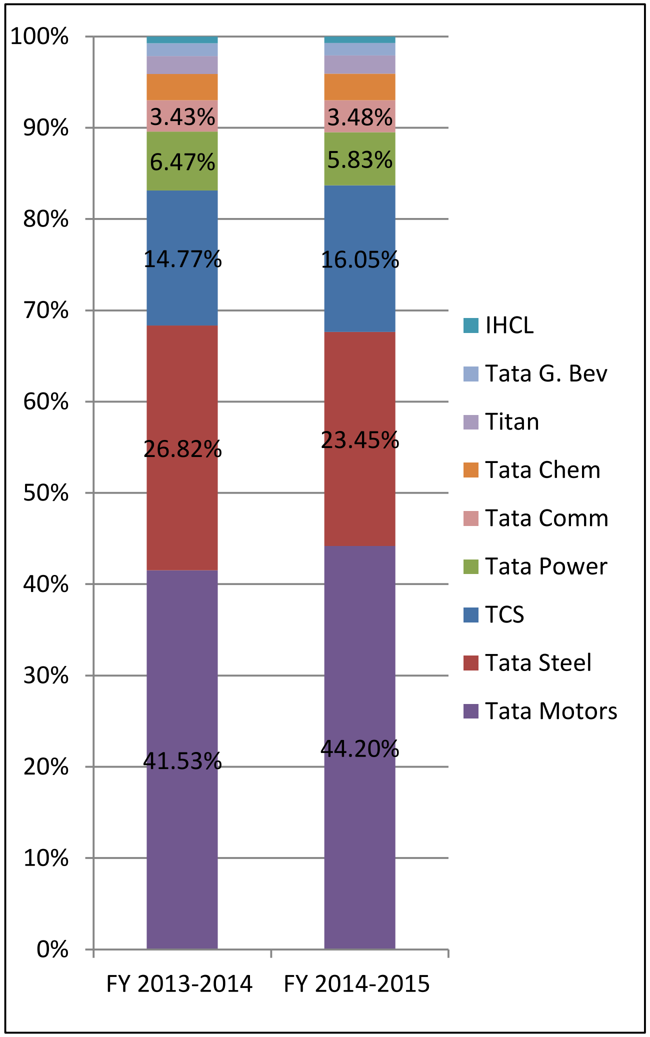
The Tata Experience

An Overview

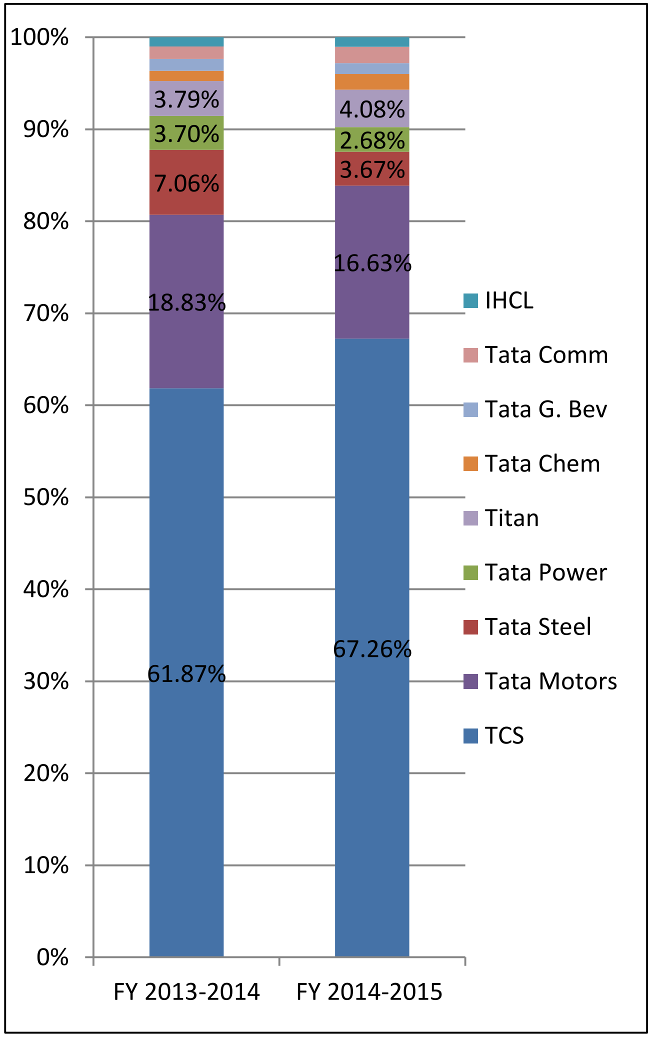
The Tata Group

- A notable conglomerate in India and worldwide, with business concerns ranging from the automotive industry to communications and tea.
- The largest businesses (by revenue) are Tata Motors, Tata Steel, TCS (Tata Consultancy Services), Tata Power, Tata Communications, and Tata Chemicals.
- There are a total of thirty publicly listed Tata companies, with a combined market capitalization of about $130 billion.
- Each company is indepe-ndently governed and operated – however, a holding company (Tata Sons) holds a significant proportion of the stakes in the individual enterprises.
- TCS and Tata Motors, in particular, have shown excellent growth and have capitalized on expanding outside of the Indian market. TCS in particular contributes an outsized role in Tata's broader financial success.

Tata Group Revenues by Company



Tata Group Mkt. Cap. by Company



The TCS Effect

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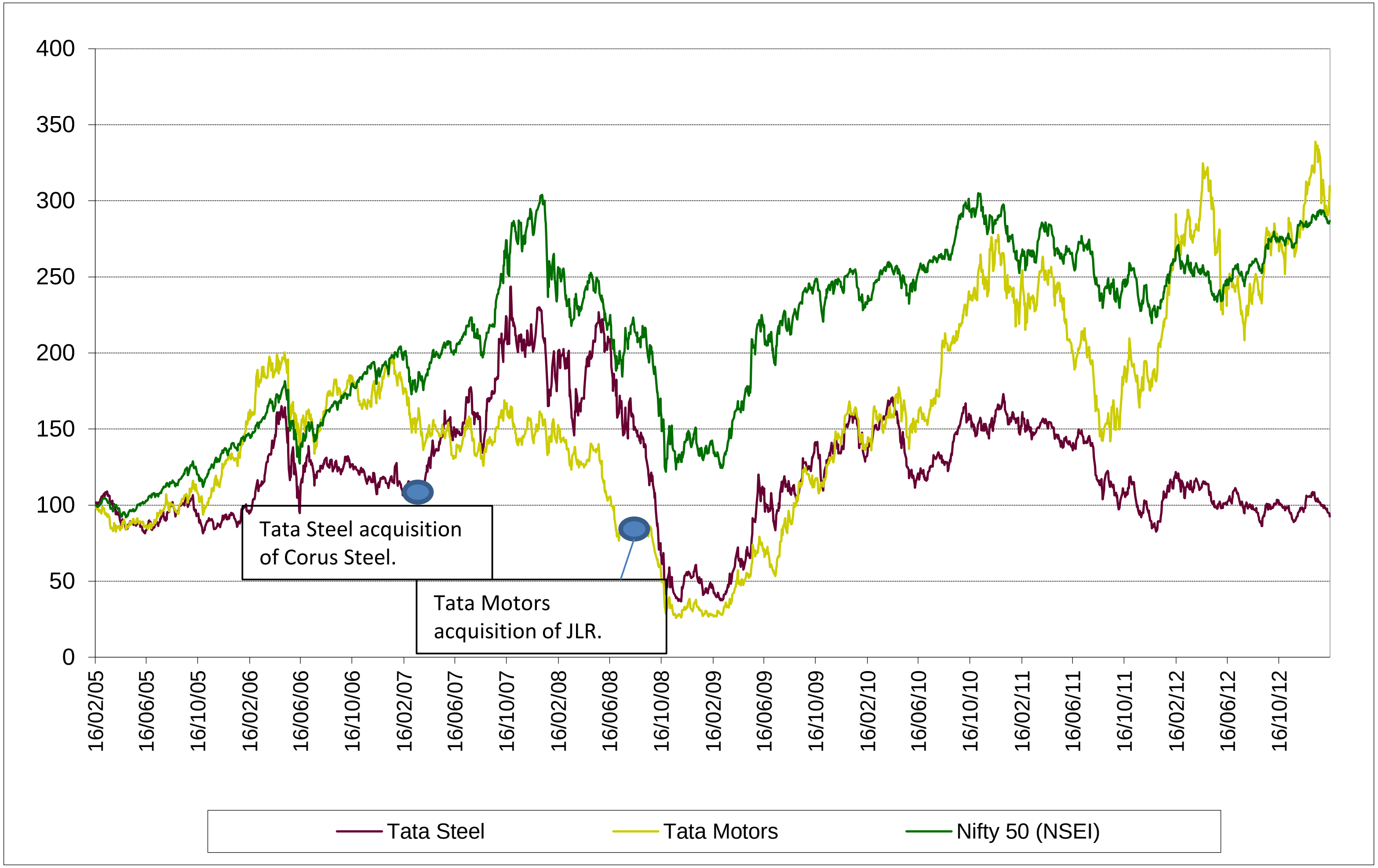
Influence of TCS on Tata Group Results – 3 Year View (USD)

	Group Total			Group Total (ex-TCS)		
P&L	FY 2013	FY 2014	FY 2015	FY 2013	FY 2014	FY 2015
Revenue	86,553.16	93,035.10	94,796.52	74,951.82	79,382.00	79,656.41
% of Group Total	*100.0%*	*100.0%*	*100.0%*	*86.6%*	*85.3%*	*84.0%*
Growth from last year (%)	*15.1%*	*23.8%*	*7.6%*	*11.9%*	*21.1%*	*5.7%*
Gross Profit	28,703.89	32,381.08	33,027.13	24,390.12	27,076.21	27,936.79
Gross Margin	33.2%	34.8%	34.8%	32.5%	34.1%	35.1%
EBITDA	11,960.62	14,084.99	13,445.45	8,640.77	9,887.07	9,529.38
% of Group Total	*100.0%*	*100.0%*	*100.0%*	*72.2%*	*70.2%*	*70.9%*
EBITDA Margin(%)	*13.8%*	*15.1%*	*14.2%*	*11.5%*	*12.5%*	*12.0%*
EBITDA 1 Yr Growth (%)	*13.7%*	*45.6%*	*2.1%*	*7.8%*	*38.6%*	*4.1%*
Interest Expense	(1,937.01)	(2,122.95)	(2,150.50)	(1,928.07)	(2,116.52)	(2,133.84)
% of Revenue	*2.2%*	*2.3%*	*2.3%*	*2.6%*	*2.7%*	*2.7%*
Net Income	3,151.64	6,044.87	5,017.12	588.37	2,846.62	1,841.53
% of Group Total	*100.0%*	*100.0%*	*100.0%*	*18.7%*	*47.1%*	*36.7%*
Net Margin(%)	*3.6%*	*6.5%*	*5.3%*	*0.8%*	*3.6%*	*2.3%*
Earnings to Tata Sons	1,939.62	3,112.07	2,770.27	47.09	750.73	425.67
Total Dividend Paid	1,755.15	1,356.72	3,169.43	704.74	442.15	446.81
Dividends to Tata Sons	966.11	794.12	2,128.06	190.57	118.88	117.88
% of Tata Sons Total	*100.0%*	*100.0%*	*100.0%*	*19.7%*	*15.0%*	*5.5%*
Balance Sheet						
Cash and Equivalents	8,199.5	9,936.1	10,440.6	6,952.8	7,525.9	7,472.4
% of Revenue	9.5%	10.7%	11.0%	9.3%	9.5%	9.4%
Total Assets	92,972.2	100,276.4	98,700.1	83,363.9	89,071.8	86,917.2
Total Asset Turnover	*0.95*	*0.96*	*0.95*	*0.91*	*0.92*	*0.91*
Total Debt	34,594.9	35,585.3	35,438.3	34,552.1	35,535.8	35,381.0
Total Debt/Equity	*1.27*	*1.10*	*1.25*	*1.73*	*1.49*	*1.76*
Total Equity	27,218.4	32,211.0	28,418.7	19,972.6	23,882.7	20,138.7
Return on Equity (%)	11.5%	20.3%	16.6%	2.8%	13.0%	8.4%

Note: Earnings to Tata Sons calculated by multiplying Net Income and Shareholding
Source: CapitalIQ

Two Acquisitions – Two Divergent Outcomes

Tata Motors and Tata Steel – Pre- and Post-Acquisition



Two Acquisitions – Two Divergent Outcomes

Tata Steel and the Acquisition of Corus Steel

- Tata Steel acquired Anglo-Dutch steelmaker Corus Group plc on 30 January 2007 at 608 pence per share, or an all cash deal of USD 12.04 billion.
- The acquisition vastly expanded Tata Steel's operations, rendering Tata Steel the worlds fifth-largest steel group.
- The final deal structure:
  - USD 3.5-3.8 billion infusion from Tata Steel (USD 2 billion as its equity contribution; USD 1.5 to 1.8 billion through a bridge loan.
  - USD 5.6 billion through an LBO (USD 3.05 billion through senior term loan, USD 2.6 billion through a high yield loan.
- Prior to the acquisition (2006), approximately 67.4% of revenues and 86.4% of assets were in India – post-acquisition (2008), 84.6% of revenues and 78.7% of assets were outside of India.
- Despite a post-acquisition boost in market value, the deal proved to be very costly as Europe fell into stagnation. Corus' sagging (now branded Tata Steel Europe) dragging down Tata Steel's growing business in India.
  - The financial crisis of 2008 and subsequent European economic malaise has troubled Tata Steel's financials.
  - Pre-acquisition EBITDA margins hovered around 30% -- they now are below 10%.
  - Net Income was consistently positive before the acquisition – it has been negative three of the past seven years, and NI margins have decreased from around 20% to ±5%.

Tata Motors and the Acquisition of Jaguar-Land Rover

- Tata Motors Ltd. acquired Jaguar Land Rover from Ford Motors on 2 June 2008 for USD 2.532 billion, approximately half of what Ford had paid for the combined consideration of Jaguar and Land Rover years earlier.
- This expanded Tata Motors' exposure towards the outside-of-India market, where it had previously been primarily domestically focused.
- The final deal structure:
  - USD 2.4 billion in cash from Tata Motors.
  - USD 132 million in the final settlement of the purchase price.
- Prior to the acquisition (2007), approximately 82.4% of revenues and 91.5% of assets of Tata Motors were in India – post-acquisition, 63.1% of assets and 51.3% of assets were outside of India. By 2015, only 13.6% of revenues and 26.6% of assets were in India.
- Immediate market reaction to the acquisition was affected by the 2008 financial crisis, however, Tata Motors went from consistently underperforming the benchmark Nifty 50 to outperform it by 2015.
- The acquisition has been widely considered a great success:
  - Healthy net income margins of c. 10% have been maintained throughout the pre- and post-acquisition period, barring 2009 results which reflect the effects of the 2008 crisis.
  - Net income has more than quadrupled since 2008, now at just over USD 2 billion in FY 2015.
  - Considering that Ford was reportedly unable to make Jaguar profitable during its ownership, these results are impressive.

The Challenges of the Tata group

The domestic challenge

- The Tata group is considered to be the most respected Group in India because of its integrity. It is however, a true challenge for the Group to operate ethically in an ocean of corruption and with competitors who are using corruption as a competitive advantage.
- About 66 percent of the equity capital of Tata Sons is held by philanthropic trusts endowed by members of the Tata family. The largest of these trusts are the Sir Dorabji Tata Trust and the Sir Ratan Tata Trust, which were created by the families of the sons of Jamsetji Tata, the Founder. Tata Sons has not been in a position to raise equity.
- With $ 35 billion of debt, the Tata Group (with the exception of TCS) is constrained in its ability to realize its objectives in a country where the Government 10-year bonds yield between 7.50 and 8.50%.
- The accounting principles are unduly penalizing borrowings in foreign currencies even though many group companies have foreign assets.
- With a BBB-, India penalizes companies who have great debt ratios since the agencies do not grand higher ratings to companies than their countries. As an example, TCS would not be granted the AA rating it deserves with almost no debt on the balance sheet. This attitude of rating agencies is one of the remnants of colonialism and penalizes emerging markets, and India in particular.
- The governance in India is not based on international norms. Often enough, the management is effectively independent and accountable only to itself. The ability of leading shareholders (promoters) to intervene is therefore limited.

The international challenge

- The international initiatives of Indian Companies have been a mixed bag of successes and failures. This is also the case of the Tata Group.
- The globalization of the corporate structures has not happened and the management is heavily centralized in Mumbai. One of the consequences of acquisitions or investments outside of India is a deployment of thousands of Indian executives born and raised in India. Indian companies are proud and Indian executives.
- The temptation id to recreate an Indian world abroad. This weakens the competitiveness of Indian companies. Indian Companies are heavily staffed by top Indian executives. Their multiculturalism is limited. TCS is by far the most international company of the Tata Group.
- The financing of international activities is heavily constrained by the structure of the Tata group, the limits of the Indian capital markets and the rating imposed by Western agencies. This is a heavy handicap that can only be overcome by creating strong local structures, incorporated locally and managed by a mix of Indian and local talents.
- The perception that Indian companies basically outsource their activities to India and use a cost competitive advantage has created a strong resistance and serious political backlash, especially in the United States where limits to visas have been put in place. This is particularly true by using limitations on visas and operations in client premises in the United States.
- The globalization of Indian Companies has not started. It is a huge cultural challenge. Their ability to internationalize has been curtailed by restrictive Indian regulation as well, that prohibit the "conversion" of Indian Companies into foreign companies.