investor's eye

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Index

Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Aurobindo	28-May-07	684	**781**	914
BASF	18-Sep-06	220	**258**	300
JP Associates	30-Dec-03	125	**703**	850
UltraTech	10-Aug-05	384	**810**	935
Zensar Tech	18-Jun-07	342	**325**	484

Ashok Leyland

Ugly Duckling

Stock Update

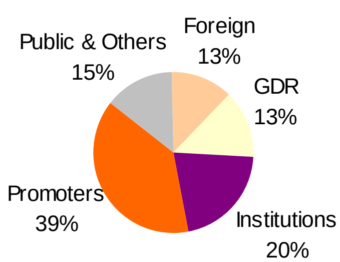
Annual report review

Buy; CMP: Rs38

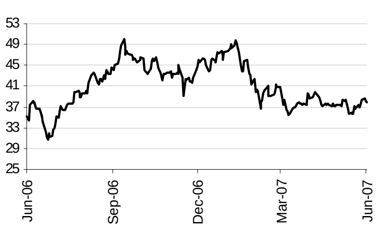
Company details

Price target:	Rs42
Market cap:	Rs5,030 cr
52 week high/low:	Rs51.2/30.5
NSE volume: (No of shares)	39.5 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Sharekhan code:	ASHOKLEY
Free float: (No of shares)	63.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.8	-6.1	-14.1	29.0
Relative to Sensex	-4.2	-15.4	-19.4	-12.0

We went through the recently released annual report of Ashok Leyland. We present the highlights below.

Key points

- Ashok Leyland had a splendid FY2007 as the commercial vehicle (CV) sales were driven by the strong availability of freight and the Supreme Court's ban on the overloading of trucks.
- The company made substantial improvement in its operating efficiencies during the year with the success of its "Mission Gemba". The operating profit margin for the year declined by 80 basis points to 9.2% even though the raw material cost as a percentage of sales rose to 74.4% from 71.9% last year. The company also made substantial improvement in its working capital management during the year.
- The return ratios also improved smartly as the return on capital employed rose from 21.7% to 25.8% while the return on net worth rose from 20.2% to 21.5% during the year.
- The company expects FY2008 to be moderate for the industry, as the demand would be affected by the increase in the interest rates. However, increased investments by the government in the infrastructure sector could encourage growth.
- The company maintains its target of making over 100,000 vehicles in FY2008, and has drawn up aggressive plans to increase its annual capacity and sales to over 180,000 vehicles each in the next four to five years. It would also look to increase the share of the non-cyclical business to de-risk its business model.
- At the current market price of Rs38 the stock discounts its FY2009E earnings by 9x and quotes at an enterprise value/earnings before interest, depreciation, tax and amortisation of 6.2x. We maintain our Buy call on the stock with a price target of Rs42.

Earnings table

Particulars	FY2005	FY2006	FY2007	FY2008E	FY2009E
Net sales (Rs cr)	4,247.7	5,329.8	7,320.4	7,996.3	8,957.6
Net profit (Rs cr)	271.4	327.0	441.3	461.9	560.3
% y-o-y growth		*20.0*	*35.0*	*5.0*	*21.0*
EPS (Rs)	1.8	2.2	3.1	3.5	4.2
% y-o-y growth		*20.0*	*35.0*	*5.0*	*21.0*
PER (x)	21.5	17.7	12.4	10.9	9.0
P/BV (Rs)	4.3	3.6	2.7	2.4	2.0
EV/EBIDTA (x)	11.8	8.9	7.5	7.3	6.2
RoCE (%)	19.3	21.7	25.8	23.2	24.2
RoNW (%)	20.0	20.2	21.5	21.7	22.7

Buoyant FY2007 performance led by CV boom

The boom in the country's CV sector due to strong availability of freight and the Supreme Court's ban on the overloading of trucks led to a sharp improvement in the performance of Ashok Leyland in FY2007. The company's top line grew by a strong 37.4% to Rs8,475.4 crore. Looking at the divisional sales, the CV sales grew by 48% to Rs7,776 crore, led by a volume surge of 35%. The revenues from the engine division grew by 15% to Rs153 crore on sales of 8,904 engines. The revenues from the spares division stood at Rs546.8 crore in FY2007.

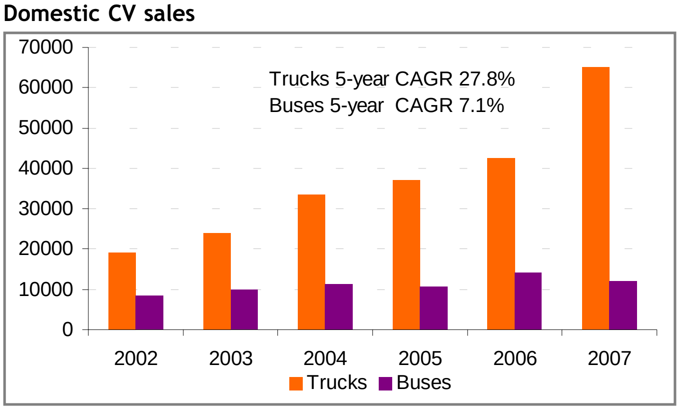
Divisional sales

(in crore)	FY04	FY05	FY06	FY07
CVs	3,420	4,178	5,251	7,776
% growth		*22.2*	*25.7*	*48.1*
Engines	86	115	132	153
% growth		*34.0*	*14.7*	*15.3*
Spares parts	447	546	784	547
% growth		*22.2*	*43.6*	*-30.2*
Gross sales	3,953	4,839	6,167	8,475
% growth		*22.4*	*27.4*	*37.4*

Volume-led growth

The overall CV sales for the year grew by 35% to 83,094 vehicles, with the domestic sales of 77,069 vehicles (marking a growth of 35.7%). The exports grew by 23% to 6,025 vehicles. The sales of trucks grew by 49% while the sales of buses grew by 9.4% during the year. In the exports market, the company's newly upgraded Falcon bus was very well accepted in the Middle East. Going forward, the export business would also receive a boost from the new plant that is being set up in the UAE. The new plant shall be operational from March 2008.

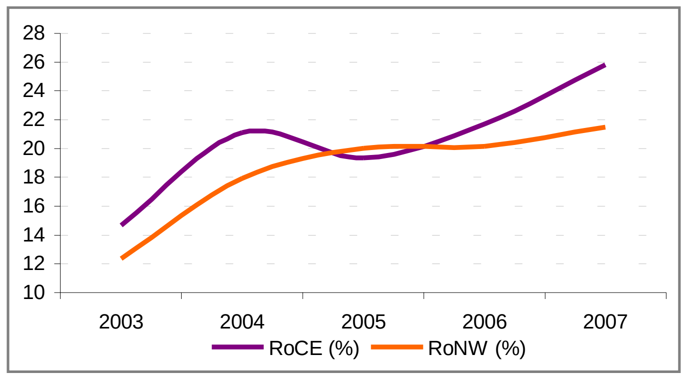
Domestic CV sales



Better operating efficiencies support margins despite high raw material cost

Ashok Leyland achieved better operating efficiencies during the year, which helped it to mitigate the impact of the high raw material prices. This was possible due to the success of "Mission Gemba", a programme initiated by the company with an objective to improve its productivity. All this aided the company to protect its margins in a rising raw material price scenario. The operating profit margin for the year declined by 80 basis points to 9.2% even though the raw material cost as a percentage of sales rose to 74.4% from 71.9% last year. The company also made substantial improvement in its working capital management during the year. This is evident from the fact that the inventory days declined from 61.8 days in FY2006 to 53.4 days in FY2007. Also, the debtor days reduced from 29.1 in FY2006 to 26.1 days in the same period. The return ratios also improved smartly as the return on capital employed rose from 21.7% to 25.8% and the return on net worth rose from 20.2% in FY2006 to 21.5% during the year.

Steadily improving return ratios



Capital expenditure

Ashok Leyland spent a total of Rs580 crore during the year, to increase its capacity from 77,200 vehicles to 84,000 vehicles, and also for new product development. For future the company has drawn out an ambitious capital expenditure (capex) plan. It would spend close to about Rs4,000 crore in the next four years for new product development and capacity expansion. Out of the Rs4,000-crore capex, about half would be generated through internal accruals, while the remaining Rs2,000 crore would be raised through a mix of debt and convertible bonds. For the same, the company had recently announced that it would raise $250 million through external commercial borrowings. As on March 31, 2007, the company had cash of Rs435 crore while its debt/equity ratio stood at 0.34, with just about 5.4% of the $100 million foreign currency convertible notes remaining to be converted.

The company has also drawn up ambitious plans to catapult Auto Component Group's revenues to $100 million by FY2009, which would be done by widening its product range and entering into new export markets in the USA, Europe, South East Asia and West Asia.

Other new developments

Acquisition of Czech truck maker

One of the important events for the company during the year was the acquisition of the truck business of the Czech truck maker, Avia. The acquisition would aid Ashok Leyland to gain a foothold in some of the European markets. Avia manufactures 6-12-tonne trucks and has the capacity to manufacture up to 20,000 vehicles a year. It also has a state-of-the-art paint shop, and a research and development facility. The company has good presence in the European markets and countries like the Czech Republic, Hungary, the UK, Ireland, Slovakia, Italy and Spain. It manufactures the popular D-series truck (consisting of 6-tonne, 7.5- tonne and 9-tonne models), which has built good brand equity in the European markets.

Setting up assembly unit in UAE

The company is also setting up a bus assembly unit at Ras Al Khaimah in the UAE. The company has signed a memorandum of understanding with Ras AL Khaimah Investment Authority for the same. The unit, with an initial annual capacity of 1,000 buses, will start operations as a bus body assembly using Ashok Leyland's chassis and bus body completely knocked down kits sourced from India. In the second phase of the project the bus assembling unit will be upgraded to a vehicle assembling unit (trucks and buses).

Outlook and valuation

On the industry outlook the company has said in its annual report, "The demand outlook for 2007-08 is mixed. While an increase in interest rates could stunt demand, increased infrastructure investments by the Government could encourage growth. In view of this, India's CV industry is likely to report moderate growth during the current year."

During the year, the company expanded its capacity to 84,000 units and is poised to achieve a target of over 100,000 vehicles in FY2008. Further, it has drawn up aggressive plans to increase its both annual capacity and sales to over 180,000 vehicles in the next four-five years. As per the company, it is "also pursuing plans to increase the share of the non-cyclical business including exports, non-auto engines and sale of Defence sector to mitigate the impact of cyclicality".

We expect a volume growth of 5% for the current year as we expect the volumes to be adversely affected in the first half of the year. However, the margins for the first half are expected to be better due to the higher sales coming from the bus segment. At the current market price of Rs38 the stock discounts its FY2009E earnings by 9x and quotes at an enterprise value/earnings before interest, depreciation, tax and amortisation of 6.2x. We maintain our Buy call on the stock with a price target of Rs42.

The author doesn't hold any investment in any of the companies mentioned in the article.

Cement

Sector Update

Impact of hike in coal royalty

Last week the government increased the royalty on the coal produced and consumed domestically. The royalty, which is charged at a specific rate, will now be charged at an ad-valorem rate of 14%. This will affect the coal consuming industries like power, cement and steel. We have assessed the implications of the same for the cement industry.

For a typical cement company, its coal cost accounts for 15-20% of its total cost. Cement companies consume non-coking coal as a fuel for heating their kiln and also for their thermal captive power plants. The southern companies source coal from Singareni Collieries whereas the northern counterparts source it from Coal India. The rate varies depending on the grade of the coal used by the companies.

Assuming that a company consumes 150-200kg of coal per tonne of cement and depends fully on domestic coal to meet its requirements, the cost per bag of cement will go up by Rs2-3, depending on the grade of the coal used. We believe that the companies will easily be able to pass on the price hike to the consumers, considering the tight demand-supply situation in the country coupled with the clarification given by the finance minister that the government will not exercise any control on the prices of cement going forward. Singareni Collieries, which supplies coal to all south-based companies, has hiked the royalty by Rs300 per tonne and we understand that in Andhra Pradesh the cement prices have already been hiked by Rs7 per bag w.e.f June 19, 2007.

For our south-based companies India Cements and Madras Cement, the cost rise would be marginal as 50-60% of their coal requirements is imported which insulates them from fluctuations in the domestic prices of coal. India Cements believes that the hike will result in a marginal cost increase of Rs1 per bag. Amongst the north-based companies, Shree Cement would not be affected as it uses petcoke as a fuel. The impact on JK Cement too would be marginal as its domestic coal consumption stands at a low 10-15%.

Thus we believe that the impact of the hike in the royalty on coal will be nil on cement companies, as they would be able to comfortably pass on the increase in their royalty cost to the consumers, as being witnessed in Andhra Pradesh.

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Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Udyog
Lupin
Nicholas Piramal India
Omax Autos
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Cipla
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Tourism Finance Corporation of India
Transport Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
Network 18 Fincap
New Delhi Television
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax
UTI Bank

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Fem Care Pharma
Genus Power Infrastructures
Hexaware Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
JM Financial
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
South East Asia Marine Engineering & Construction
Subros
Sun Pharmaceutical Industries
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