Equities

1 February 2012 | 11 pages

# Ashok Leyland (ASOK.BO)

## 3QFY12 Results Miss Meaningfully

- **3QFY12 PAT of Rs 669mn significantly below estimates** — Driven by a big miss (~30%) at the EBITDA level which was Rs2.1bn (7.3%). The miss was on account of higher staff expenses (explained as a bonus payout to employees) and a sharp (and inexplicable) rise in other expenses. Higher capital costs (depreciation) / lower financial income resulted in PBT missing estimates by ~54%, while a lower effective tax rate resulted in a PAT missing estimates by 47%.
- **Market Trends** — Ashok Leyland's market share in the domestic truck segment declined ~320bps Q/Q at ~18%. Per SIAM data, Ashok Leyland lost market share to key competitor, Tata Motors, as well as Eicher Motors. While this could be a result of a slowdown in ALL's dominant market, i.e. southern India, we await mgmt's comments in tomorrow's call for more color. ALL gained ~270bps in the domestic bus segment, reflecting a very strong December 2011 when ALL had ~48% market share. Mgmt noted that 3Q was marred by supply chain issues- again, we await more details
- **What to look for in the con call** — We await details from mgmt on four key aspects – **1) Volume guidance**- While the 100k volume guidance appears manageable, for now, we would like to get more details on the contribution of the Dost LCV- a low margin product; **2) Supply chain issues**- ALL has been plagued by recurrent logistic / supply chain issues. We await mgmt views on recurrence of such problems in the future; **3) Overall sector view** - ALL mgmt had started FY12 with a flattish volume growth guidance which was increased to 5-6% in 2QFY12; and **4) Margin guidance-** In 2Q con call, mgmt had guided to a 10.5% EBITDA margin for FY12. With 9MFY12 margin at 9.2%, we would be watching out for any downward revision in mgmt guidance.
- **Maintain Sell** — While we await more colour on 3Q as well as mgmt guidance for FY12, we maintain our Sell recommendation on the stock, primarily owing to ALL's relatively weaker positioning vis-à-vis TTMT as well as margin pressures evident in 3Q. Downside risks, though, will now begin to dissipate, given a) valuations, b) dividend yield support, and c) a slight improvement in the macro with inflation tapering off and interest rates stabilizing.

**Statistical Abstract**

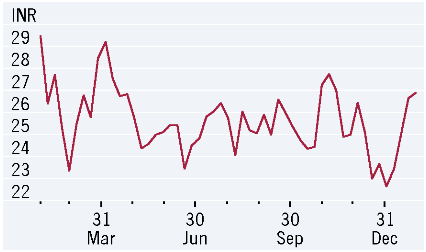
| Year to 31 Mar | Net Profit (RsM) | Diluted EPS (Rs) | EPS growth (%) | P/E (x) | P/B (x) | ROE (%) | Yield (%) |
|---|---|---|---|---|---|---|---|
| 2010A | 4,262 | 1.60 | 74.8 | 16.9 | 2.0 | 11.9 | 2.8 |
| 2011A | 6,707 | 2.52 | 57.4 | 10.7 | 1.8 | 17.6 | 3.7 |
| 2012E | 5,956 | 2.24 | -11.2 | 12.1 | 1.7 | 14.4 | 3.3 |
| 2013E | 6,844 | 2.57 | 14.9 | 10.5 | 1.5 | 15.3 | 3.8 |
| 2014E | 9,150 | 3.44 | 33.7 | 7.9 | 1.4 | 18.7 | 5.1 |

Source: Powered by dataCentral

■ Company Update

| | |
|---|---|
| **Sell** | **3** |
| Price (31 Jan 12) | Rs27.05 |
| Target price | Rs26.00 |
| Expected share price return | -3.9% |
| Expected dividend yield | 3.3% |
| **Expected total return** | **-0.6%** |
| Market Cap | Rs71,971M |
| | US$1,451M |

**Price Performance**
**(RIC: ASOK.BO, BB: AL IN)**

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

**ASOK.BO: Fiscal year end 31-Mar** — **Price: Rs27.05; TP: Rs26.00; Market Cap: Rs71,971m; Recomm: Sell**

| Profit & Loss (Rsm) | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|
| Sales revenue | 72,090 | 110,947 | 119,436 | 129,677 | 144,120 |
| Cost of sales | -54,234 | -83,909 | -91,194 | -98,559 | -107,466 |
| Gross profit | 17,856 | 27,038 | 28,242 | 31,118 | 36,654 |
| Gross Margin (%) | 24.8 | 24.4 | 23.6 | 24.0 | 25.4 |
| **EBITDA** | **7,272** | **12,445** | **12,927** | **13,873** | **16,516** |
| EBITDA Margin (%) | 10.1 | 11.2 | 10.8 | 10.7 | 11.5 |
| Depreciation | -2,041 | -2,674 | -3,503 | -3,775 | -3,717 |
| Amortisation | 0 | 0 | 0 | 0 | 0 |
| **EBIT** | **5,231** | **9,771** | **9,424** | **10,098** | **12,799** |
| EBIT Margin (%) | 7.3 | 8.8 | 7.9 | 7.8 | 8.9 |
| Net interest | -1,019 | -1,889 | -2,233 | -2,215 | -2,017 |
| Associates | 0 | 0 | 0 | 0 | 0 |
| Non-op/Except | 1,236 | 136 | 349 | 780 | 800 |
| **Pre-tax profit** | **5,448** | **8,018** | **7,540** | **8,663** | **11,582** |
| Tax | -1,211 | -1,705 | -1,583 | -1,819 | -2,432 |
| Extraord./Min.Int./Pref.div. | 0 | 0 | 0 | 0 | 0 |
| **Reported net profit** | **4,237** | **6,313** | **5,956** | **6,844** | **9,150** |
| Net Margin (%) | 5.9 | 5.7 | 5.0 | 5.3 | 6.3 |
| Core NPAT | 4,262 | 6,707 | 5,956 | 6,844 | 9,150 |

| Per share data | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|
| Reported EPS (Rs) | 1.59 | 2.37 | 2.24 | 2.57 | 3.44 |
| Core EPS (Rs) | 1.60 | 2.52 | 2.24 | 2.57 | 3.44 |
| DPS (Rs) | 0.75 | 1.00 | 0.90 | 1.03 | 1.38 |
| CFPS (Rs) | 3.89 | 3.62 | 4.40 | 3.74 | 4.80 |
| FCFPS (Rs) | 1.57 | 1.93 | 2.14 | 2.61 | 3.67 |
| BVPS (Rs) | 13.79 | 14.89 | 16.09 | 17.47 | 19.30 |
| Wtd avg ord shares (m) | 2,661 | 2,661 | 2,661 | 2,661 | 2,661 |
| Wtd avg diluted shares (m) | 2,661 | 2,661 | 2,661 | 2,661 | 2,661 |

| Growth rates | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|
| Sales revenue (%) | 21.0 | 53.9 | 7.7 | 8.6 | 11.1 |
| EBIT (%) | 94.8 | 86.8 | -3.6 | 7.2 | 26.8 |
| Core NPAT (%) | 74.8 | 57.4 | -11.2 | 14.9 | 33.7 |
| Core EPS (%) | 74.8 | 57.4 | -11.2 | 14.9 | 33.7 |

| Balance Sheet (Rsm) | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|
| Cash & cash equiv. | 5,189 | 1,795 | 2,000 | 2,500 | 3,000 |
| Accounts receivables | 10,221 | 11,852 | 14,517 | 15,677 | 17,423 |
| Inventory | 16,382 | 22,089 | 25,488 | 27,223 | 29,646 |
| Net fixed & other tangibles | 48,162 | 49,961 | 52,458 | 51,683 | 50,966 |
| Goodwill & intangibles | 0 | 0 | 0 | 0 | 0 |
| Financial & other assets | 12,866 | 20,236 | 28,140 | 30,390 | 35,390 |
| **Total assets** | **92,820** | **105,933** | **122,603** | **127,472** | **136,424** |
| Accounts payable | 23,317 | 27,074 | 35,823 | 38,147 | 41,345 |
| Short-term debt | 0 | 0 | 0 | 0 | 0 |
| Long-term debt | 22,039 | 25,683 | 30,142 | 28,919 | 28,712 |
| Provisions & other liab | 10,777 | 13,547 | 13,815 | 13,928 | 15,003 |
| **Total liabilities** | **56,133** | **66,304** | **79,780** | **80,994** | **85,060** |
| Shareholders' equity | 36,688 | 39,630 | 42,823 | 46,478 | 51,364 |
| Minority interests | 0 | 0 | 0 | 0 | 0 |
| **Total equity** | **36,688** | **39,630** | **42,823** | **46,478** | **51,364** |
| **Net debt** | **16,850** | **23,887** | **28,142** | **26,419** | **25,712** |
| Net debt to equity (%) | 45.9 | 60.3 | 65.7 | 56.8 | 50.1 |

| Valuation ratios | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|
| PE (x) | 16.9 | 10.7 | 12.1 | 10.5 | 7.9 |
| PB (x) | 2.0 | 1.8 | 1.7 | 1.5 | 1.4 |
| EV/EBITDA (x) | 11.9 | 6.8 | 6.4 | 5.7 | 4.6 |
| FCF yield (%) | 5.8 | 7.2 | 7.9 | 9.6 | 13.6 |
| Dividend yield (%) | 2.8 | 3.7 | 3.3 | 3.8 | 5.1 |
| Payout ratio (%) | 47 | 40 | 40 | 40 | 40 |
| ROE (%) | 11.9 | 16.5 | 14.4 | 15.3 | 18.7 |

| Cashflow (Rsm) | 2010 | 2011 | 2012E | 2013E | 2014E |
|---|---|---|---|---|---|
| EBITDA | 7,272 | 12,445 | 12,927 | 13,873 | 16,516 |
| Working capital | 2,806 | 6 | 1,888 | -1,457 | -896 |
| Other | 275 | -2,822 | -3,119 | -2,474 | -2,849 |
| **Operating cashflow** | **10,352** | **9,629** | **11,696** | **9,942** | **12,771** |
| Capex | -6,177 | -4,482 | -6,000 | -3,000 | -3,000 |
| Net acq/disposals | 0 | 0 | 0 | 0 | 0 |
| Other | 0 | 0 | 0 | 0 | 0 |
| **Investing cashflow** | **-6,177** | **-4,482** | **-6,000** | **-3,000** | **-3,000** |
| Dividends paid | -2,327 | -3,092 | -2,776 | -3,189 | -4,264 |
| **Financing cashflow** | **131** | **551** | **1,684** | **-4,412** | **-4,471** |
| **Net change in cash** | **4,305** | **5,699** | **7,380** | **2,530** | **5,300** |
| **Free cashflow to s/holders** | **4,175** | **5,148** | **5,696** | **6,942** | **9,771** |

For further data queries on Citi's full coverage universe please contact CIRA Data Services Asia Pacific at CIRADataServicesAsiaPacific@citi.com or +852-2501-2791

Powered by: dataCentral

**Figure 1. Ashok Leyland: 3QFY12 Results (Rs mn)**

| | 3QFY11 | 2QFY12 | 3QFY12 | % Chg YoY | % Chg QoQ | CIRA Comments |
|---|---|---|---|---|---|---|
| **Net sales** | **22,272** | **30,946** | **28,798** | **29.3%** | **-6.9%** | **~3% above estimates** |
| | | | | | | |
| Decrease/(Increase) in Stocks | (1,494) | 1,629 | (1,034) | | | |
| Raw Materials | 17,788 | 21,128 | 22,321 | 30.6% | -6.5% | ~4% above estimates |
| Staff costs | 2,179 | 2,515 | 2,723 | 25.0% | 8.3% | ~18% above estimates. Reflects bonus payout |
| Other Expenses | 1,879 | 2,362 | 2,683 | 42.8% | 13.6% | ~17% above estimates |
| | | | | | | |
| **Total Expenditure** | **20,352** | **27,634** | **26,694** | **31.2%** | **-3.4%** | **~7% above estimates** |
| | | | | | | |
| **EBITDA** | **1,920** | **3,312** | **2,104** | **9.6%** | **-36.5%** | **~30% below estimates** |
| | | | | | | |
| Interest | 475 | 627 | 550 | 15.9% | -12.3% | ~21.4% below estimates |
| Other income | 17 | 103 | 32 | 93.2% | -68.7% | ~69% below estimates |
| EBDT | 1,462 | 2,788 | 1,586 | 8.5% | -43.1% | |
| Depreciation & Amortization | 647 | 859 | 866 | 33.9% | 0.8% | ~2% above estimates |
| **PBT** | **815** | **1,929** | **720** | **-11.7%** | **-62.7%** | **-54.0%** |
| Exceptional income | | | | | | |
| Exceptional expenditure | 260 | | | | | |
| Tax | 122 | 388 | 51 | -58.4% | -86.9% | |
| **PAT** | **434** | **1,541** | **669** | **54.3%** | **-56.6%** | |
| **PAT (pre exceptionals)** | **694** | **1,541** | **669** | **-3.6%** | **-56.6%** | **~46% below estimates** |
| | | | | | | |
| **Profit Margins** | | | | | | |
| EBITDA (%) net sales | 8.6 | 10.7 | 7.3 | | | |
| Interest cover (x) | 4.1 | 5.4 | 3.9 | | | |
| Other income / EBDIT (%) | 0.9 | 3.0 | 1.5 | | | |
| Other income / PAT (%) | 2.4 | 6.7 | 4.8 | | | |
| Pre tax margins (%) | 3.66 | 6.23 | 2.50 | | | |
| Tax / PBT (%) | 11.3 | 20.1 | 7.0 | | | |
| Net profit margins | 3.1 | 5.0 | 2.3 | | | |
| | | | | | | |
| **Cost ratios** | | | | | | |
| Raw materials / sales | 73.2 | 73.5 | 73.9 | | | |
| Staff costs / sales | 9.8 | 8.1 | 9.5 | | | |
| Other expenses / sales | 8.4 | 7.6 | 9.3 | | | |

Source: Companies, Citi Investment Research and Analysis

**Ashok Leyland started selling the Dost LCV (in JV with Nissan) in 3Q. Thus LCV sales include ~2,490 Dost LCVs (our estimate based on SIAM data). This mix shift impacted realizations negatively on a Q/Q basis. However, it was partly compensated for by a decline in material cost / vehicle**

**Figure 2. Ashok Leyland: Operational Metrics (Rs)**

| | 3QFY11 | 2QFY12 | 3QFY12 | % Chg YoY | % Chg QoQ |
|---|---|---|---|---|---|
| Average Realizations | 1,208,030 | 1,309,705 | 1,227,744 | 1.6% | -6.3% |
| Material Cost / Vehicle | 883,748 | 963,152 | 907,554 | 2.7% | -5.8% |
| Gross Contribution / Vehicle | 324,282 | 346,553 | 320,191 | -1.3% | -7.6% |
| EBITDA / Vehicle | 104,153 | 140,154 | 89,688 | -13.9% | -36.0% |

Source: Company, Citi Investment Research and Analysis

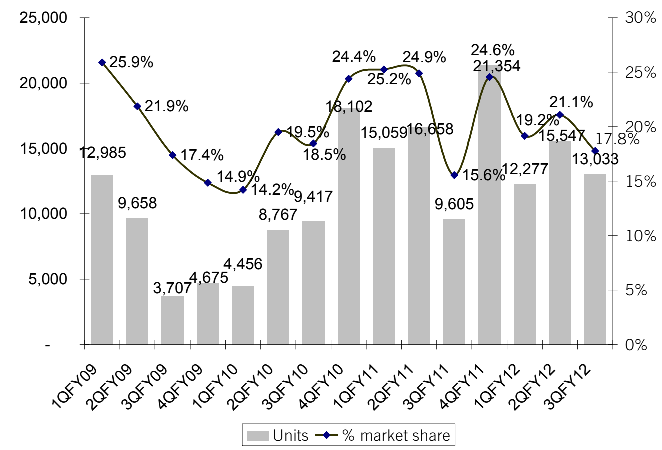
**Figure 3. Ashok Leyland: Operational Results**

| | 3QFY11 | 2QFY12 | 3QFY12 | % Chg YoY | % Chg QoQ |
|---|---|---|---|---|---|
| MHCV Passenger | | | | | |
| Domestic Sales | 5,180 | 4,741 | 4,603 | -11.1% | -2.9% |
| Export sales | 1,494 | 1,384 | 1,022 | -31.6% | -26.2% |
| **Total MHCV Passenger Sales** | **6,674** | **6,125** | **5,625** | **-15.7%** | **-8.2%** |
| | | | | | |
| MHCV Goods | | | | | |
| Domestic Sales | 9,604 | 15,547 | 13,033 | 35.7% | -16.2% |
| Export sales | 1,979 | 1,678 | 1,664 | -15.9% | -0.8% |
| **Total MHCV Goods Sales** | **11,583** | **17,225** | **14,697** | **26.9%** | **-14.7%** |
| | | | | | |
| LCV | | | | | |
| Domestic Sales | 139 | 110 | 2,562 | 1743.2% | 2229.1% |
| Export sales | 40 | 168 | 331 | 727.5% | 97.0% |
| **Total LCV Sales** | **179** | **278** | **2,893** | **1516.2%** | **940.6%** |
| | | | | | |
| Total Domestic | 14,923 | 20,398 | 20,198 | 35.3% | -1.0% |
| Total Export | 3,513 | 3,230 | 3,017 | -14.1% | -6.6% |
| **Total Sales** | **18,436** | **23,628** | **23,215** | **25.9%** | **-1.7%** |

Note: Since the company changed its reporting format, we do not get separate LCV / MHCV data. We thus use SIAM data, which could differ slightly from company data

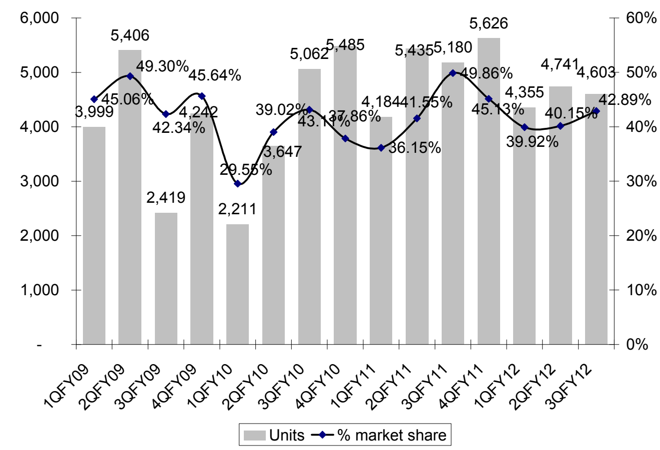
Source: SIAM, Company, Citi Investment Research and Analysis

**Figure 4. Ashok Leyland : Domestic Goods MHCV Sales Trend**



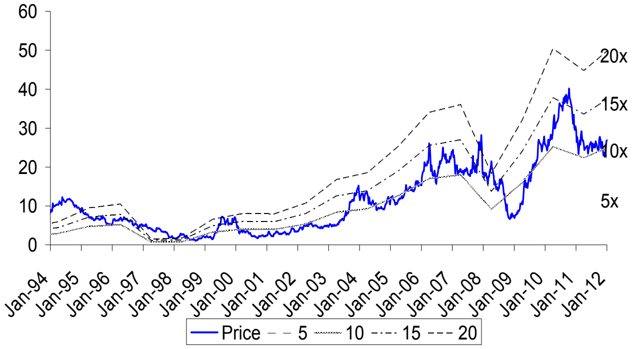

Source: SIAM, Citi Investment Research and Analysis

**Figure 5. Ashok Leyland : Domestic Passenger MHCV Sales Trend**



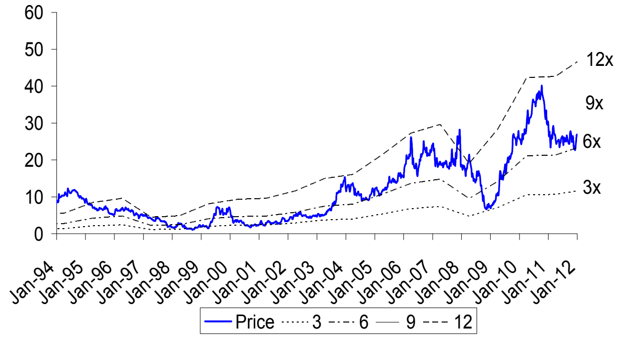

Source: SIAM, Citi Investment Research and Analysis

**Figure 6. Ashok Leyland: 1 Yr fwd P / EPS (x)**



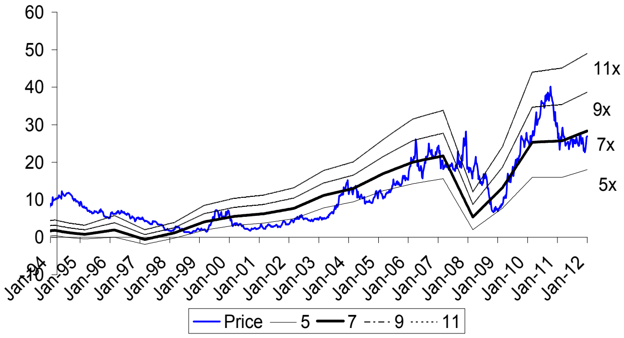

Source: Company, Citi Investment Research and Analysis

**Figure 7. Ashok Leyland: 1 Yr fwd P / CEPS (x)**



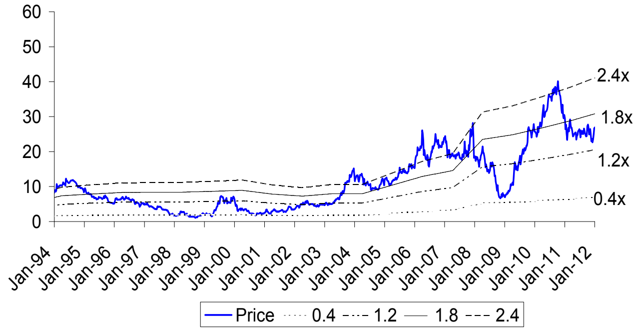

Source: Company, Citi Investment Research and Analysis

**Figure 8. Ashok Leyland: 1 Yr fwd EV / EBITDA (x)**




Source: Company, Citi Investment Research and Analysis

**Figure 9. Ashok Leyland: 1 Yr fwd P / BVPS (x)**




Source: Company, Citi Investment Research and Analysis

# Ashok Leyland

## Company description

ALL is owned by the Hinduja Group (which has an equity stake of 50.9%). ALL is the second-largest CV manufacturer in India, with a strong focus on medium and heavy commercial vehicles (MHCVs). The company's core product portfolio comprises MHCVs (goods vehicles and buses), and it also manufactures a range of vehicles suited for defense and special applications. Its recent successes in the export market are indicative of its product quality. Sales of spares and engines add to revenue and earnings, especially during cyclical downturns.

## Investment strategy

We rate shares of Ashok Leyland Sell (3). Growth prospects for ALL are deteriorating. The ramp up at its Pantnagar plant has resulted in capacity increase as well as cost savings (primarily excise savings). However, with its focus on only medium and heavy trucks (coupled with geographical concentration in South India) ALL is more vulnerable than its peer Tata Motors to a deceleration in CV sales. Over the long term, the outlook for CV sales remains healthy, key reasons being a sustained pickup in economic activity, a focus on infrastructure spending and a strong replacement cycle (15% of the existing fleet in India is more than 15 years old and needs to be replaced both for commercial and environmental reasons). Moreover, growth in the agriculture, infrastructure and manufacturing sectors - all of which have positive linkages to the freight business - should remain positive over the long term. However, in the near to medium term we expect Ashok Leyland sales to be under pressure due to the challenging economic environment.

## Valuation

Our price target of Rs26 for ALL is based on 6.5x March 13E CEPS. Our 6.5x target multiple is set at a slight discount to the 10-year average of 7x, which we believe is warranted given the current challenging economic environment. Our target price implies ~6.5x March 13E EV/EBITDA, broadly in line with the 10-year average

## Risks

The key risk factors to our target price are movements in economic variables - particularly GDP growth, interest rates and fuel prices, to which sales of commercial vehicles are very sensitive. Input costs are volatile and linked to global commodity prices for metals, plastics, etc. The profitability and viability of the STUs over the long term are an important risk factor, given that the STUs are the largest buyers of ALL buses. Key upside risks to our target price include: 1) Greater-than-expected volume growth; 2) Significant reduction in input costs (notably steel and aluminium) would benefit earnings; and 3) Favourable customer response to the vehicles launched from ALL's LCV JV.

# Appendix A-1

## Analyst Certification

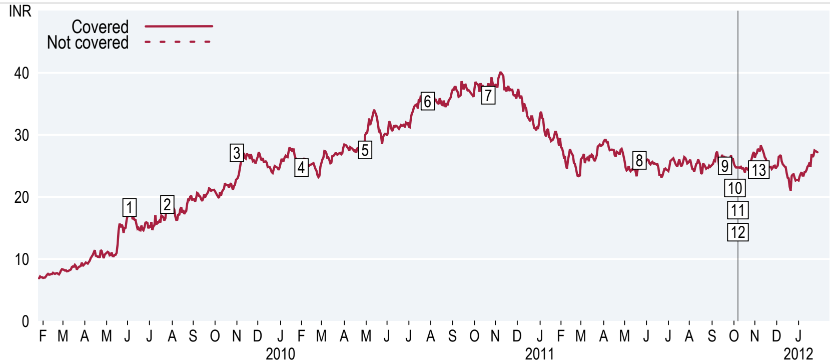
**The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.**

## IMPORTANT DISCLOSURES

### Ashok Leyland (ASOK.BO)

**Ratings and Target Price History**
**Fundamental Research**

Analyst: Jamshed Dadabhoy




| | Date | Rating | Target Price | Closing Price |
|---|---|---|---|---|
| 1 | 3-Jun-09 | 3M | *14.50 | 18.15 |
| 2 | 27-Jul-09 | 3M | *14.00 | 17.48 |
| 3 | 2-Nov-09 | 3M | *21.50 | 22.73 |
| 4 | 1-Feb-10 | 3M | *24.50 | 25.83 |
| 5 | 30-Apr-10 | 3M | *26.00 | 29.98 |
| 6 | 28-Jul-10 | 3M | *32.50 | 36.25 |
| 7 | 21-Oct-10 | 3M | *36.00 | 38.30 |
| 8 | 23-May-11 | 3M | *26.00 | 25.00 |
| 9 | 20-Sep-11 | 3M | *24.50 | 26.10 |
| 10 | 4-Oct-11 | 3M | *23.20 | 24.95 |
| 11 | 7-Oct-11 | Stock rating system changed | | |
| 12 | 7-Oct-11 | *3 | 23.20 | 24.75 |
| 13 | 6-Nov-11 | 3 | *26.00 | 27.75 |

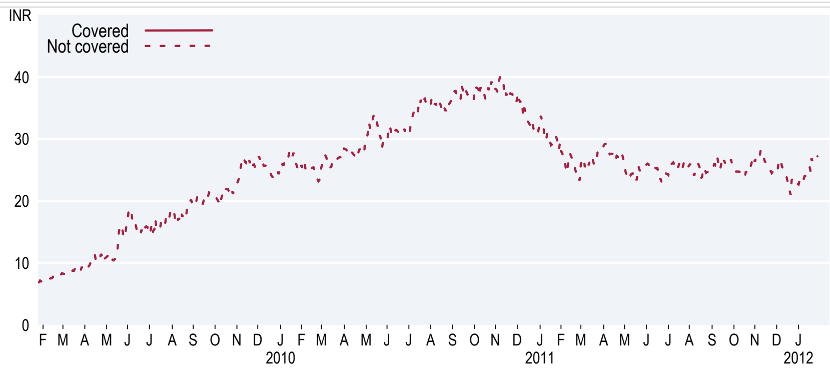
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

### Ashok Leyland (ASOK.BO)

**Ratings and Target Price History**
**Best Ideas Research**
**Relative Call (3 Month)**

Analyst: Jamshed Dadabhoy




* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Citigroup Global Markets Inc. or its affiliates beneficially owns 1% or more of any class of common equity securities of Ashok Leyland. This position reflects information available as of the prior business day.

Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Ashok Leyland in the past 12 months.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: Ashok Leyland.

Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, non-securities-related: Ashok Leyland.

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**Citi Investment Research & Analysis Ratings Distribution**

| | *12 Month Rating* | | | *Relative Rating* | | |
|---|---|---|---|---|---|---|
| ***Data current as of 31 Dec 2011*** | **Buy** | **Hold** | **Sell** | **Buy** | **Hold** | **Sell** |
| Citi Investment Research & Analysis Global Fundamental Coverage | 57% | 34% | 9% | 10% | 79% | 10% |
| *% of companies in each rating category that are investment banking clients* | 45% | 41% | 40% | 49% | 43% | 41% |

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