



## Ashok Leyland

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,934	AL IN
	REUTERS CODE
S&P CNX: 4,117	ASOK.BO

4 May 2007

Buy

Previous Recommendation: Buy

Rs40

Equity Shares (m)	1,323.7
52-Week Range	53/30
1,6,12 Rel. Perf. (%)	2/-16/-35
M.Cap. (Rs b)	52.3
M.Cap. (US\$ b)	1.3

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	71,682	4,276	3.2	30.5	12.2	3.2	26.9	24.4	0.6	6.6
3/08E	81,198	4,994	3.8	16.8	10.5	2.8	26.4	27.3	0.5	5.4
3/09E	89,310	5,689	4.3	13.9	9.2	2.4	26.1	28.5	0.5	4.4

- ✍ In 4QFY07, Ashok Leyland's (ALL) sales, EBITDA and adjusted PAT grew by 32.3%, 20.6% and 28% YoY respectively. Results were in line with our expectation but for the lower-than-expected EBITDA margin.
- ✍ Revenue growth of 32.3% YoY to Rs22.9b is driven by volume growth of 28.3% YoY and improvement in realizations by 3.1%. Adj. EBITDA margin declined to 11.3% (-110bp YoY but +80bp QoQ), while EBITDA was Rs2.6b (adj. for forex gain of Rs53.8m). Margins have been hampered by higher staff costs and other expenditure.
- ✍ Depreciation increased by 45.8% due to ongoing capacity expansion. As a result, Ashok Leyland reported 28% growth in adjusted PAT to Rs1.7b.
- ✍ For the full year FY07, ALL reported 36.6% increase in net sales to Rs71.7b. EBITDA margin was 9.8% as EBITDA increased 30.3% to Rs7b. Adj. PAT increased 41.4% to Rs4.3b.
- ✍ We have revised our estimates downward, mainly on account of higher-than-expected depreciation and to account for lower EBITDA margins. Compared with the 9.8% EBITDA margin in FY07, we expect margins to be 10% in FY08 and 10.2% in FY09 respectively.
- ✍ The stock is trading at 10.5x FY08 revised EPS of Rs3.8 and 9.2x FY09 revised EPS of Rs4.3. Maintain **Buy**.

### QUARTERLY PERFORMANCE

	(RS MILLION)									
	FY06				FY07				FY06	FY07
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q		
Total Volumes (nos)	13,320	14,895	13,038	20,373	17,018	19,885	20,068	26,130	61,626	83,101
<b>Net Sales</b>	<b>10,632</b>	<b>12,501</b>	<b>12,024</b>	<b>17,319</b>	<b>14,239</b>	<b>16,757</b>	<b>17,776</b>	<b>22,910</b>	<b>52,477</b>	<b>71,682</b>
Change (%)	29.5	36.7	21.8	18.7	33.9	34.0	47.8	32.3	25.5	36.6
Total Cost	9,774	11,304	10,863	15,166	13,026	15,437	15,907	20,314	47,108	64,685
<b>EBITDA</b>	<b>858</b>	<b>1,197</b>	<b>1,161</b>	<b>2,153</b>	<b>1,213</b>	<b>1,320</b>	<b>1,869</b>	<b>2,596</b>	<b>5,369</b>	<b>6,997</b>
As a % of Sales	8.1	9.6	9.7	12.4	8.5	7.9	10.5	11.3	10.2	9.8
Change (%)	14.4	60.0	13.9	25.9	41.4	10.3	61.0	20.6	27.0	30.3
Non-Operating Income	34	170	16	110	139	99	64	169	549	470
Interest	-12	7	71	98	5	4	26	19	384	53
<b>Gross Profit</b>	<b>903</b>	<b>1,359</b>	<b>1,106</b>	<b>2,165</b>	<b>1,346</b>	<b>1,415</b>	<b>1,907</b>	<b>2,746</b>	<b>5,534</b>	<b>7,414</b>
Less: Depreciation	297	342	290	330	328	365	332	481	1,260	1,506
<b>PBT</b>	<b>606</b>	<b>1,017</b>	<b>816</b>	<b>1,835</b>	<b>1,019</b>	<b>1,050</b>	<b>1,574</b>	<b>2,264</b>	<b>4,274</b>	<b>5,908</b>
Tax	271	215	250	513	262	334	463	573	1,250	1,632
Effective Tax Rate (%)	44.8	21.2	30.7	28.0	25.7	31.8	29.4	25.3	29.2	27.6
<b>Adj. PAT (before extraordinary)</b>	<b>334</b>	<b>802</b>	<b>566</b>	<b>1,322</b>	<b>756</b>	<b>716</b>	<b>1,112</b>	<b>1,692</b>	<b>3,024</b>	<b>4,276</b>
Change (%)	-2.4	76.7	0.9	10.8	126.1	-10.7	96.5	28.0	18.6	41.4
Extraordinary Income	334	0	0	0	0	268	0	54	334	268
Extraordinary Loss	25	52	21	21	65	31	59	30	85	131
<b>Rep. PAT</b>	<b>644</b>	<b>750</b>	<b>545</b>	<b>1,335</b>	<b>692</b>	<b>954</b>	<b>1,053</b>	<b>1,715</b>	<b>3,273</b>	<b>4,413</b>
Change (%)	101.5	74.4	1.5	-6.5	7.5	27.1	93.1	28.5	20.6	34.8

E: MOST Estimates

### Volumes: Strong growth of 35% in FY07

In line with the strong growth witnessed by CV companies in FY07, Ashok Leyland increased its volumes during the year by 34.8% YoY to 83,101 units. Growth was driven by the goods segment, which witnessed 49% YoY growth, spurred by the ban on overloading, ongoing infrastructure development and stable freight rates.

Due to heavy demand from the goods segment, Ashok Leyland concentrated its production more toward this segment, leading to a decline of 1.1% in domestic passenger vehicle sales. This demand, arises mainly from STU orders, where to an extent, flexibility in delivery schedules is permissible.

However, the growth rate in 4QFY07 was lower, mainly on account of the high base effect, particularly in March 2007, when sales declined marginally on a YoY basis. CV sales during the quarter increased 28.3% to 26,130 units, with the goods segment remaining the biggest growth driver (+30% YoY).

We maintain a positive view on CV sales in FY08 and FY09, with sales being driven by the structural drivers in the economy such as highway development, industrial growth, increased availability of freight, improvement in roadway networks etc. We expect 12.5% growth in volumes in FY08E and 9% growth in FY09E.

#### PRODUCT MIX (%)

	4QFY07	4QFY06	3QFY07	FY07	FY06
HCV - Goods	80.3	79.2	77.5	81.0	73.3
HCV - Passenger	19.5	19.8	22.2	18.6	25.4
<b>Total HCV</b>	<b>99.8</b>	<b>99.0</b>	<b>99.6</b>	<b>99.6</b>	<b>98.7</b>
LCV	0.2	1.0	0.4	0.4	1.3
<b>Total Sales</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
of which exports	6.7	5.8	7.2	7.3	7.2

Source: Company/Motilal Oswal Securities

#### VOLUME: STRONG GROWTH IN GOODS SEGMENT (UNIT IN NOS)

	4QFY07	4QFY06	% YOY	3QFY07	% QOQ	FY07	FY06	% CHG
HCV - Goods	20,990	16,140	30.0	15,545	35.0	67,301	45,164	49.0
HCV - Passenger	5,094	4,031	26.4	4,452	14.4	15,497	15,664	-1.1
<b>Total HCV</b>	<b>26,084</b>	<b>20,171</b>	<b>29.3</b>	<b>19,997</b>	<b>30.4</b>	<b>82,798</b>	<b>60,828</b>	<b>36.1</b>
LCV	46	202	-77.2	71	-35.2	303	798	-62.0
<b>Total Sales</b>	<b>26,130</b>	<b>20,373</b>	<b>28.3</b>	<b>20,068</b>	<b>30.2</b>	<b>83,101</b>	<b>61,626</b>	<b>34.8</b>
of which exports	1,745	1,180	47.9	1,437	21.4	6,025	4,432	35.9

Source: Company/Motilal Oswal Securities

### Gain in market share in M&HCVs

In FY07, Ashok Leyland's market share in the M&HCV domestic goods segment increased to 26.3% from 24% in FY06. However, this was at the expense of its position in the passenger carrier segment. Its share in the M&HCV domestic passenger carrier segment declined from 46.7% in FY06 to 40.7% in FY07. This drop in market share is more an indication of saturation of the company's installed capacities compared with demand growth in FY07. Moreover, due to higher CV demand from the goods segment, ALL focused most of its production activities in that direction, resulting in lower bus production.

### EBITDA margin lower

4QFY07 sales, EBITDA and adjusted PAT grew by 32.3%, 20.6% and 28% YoY respectively. Results were in line with our expectations except for the lower-than-expected EBITDA margin. Revenue growth of 32.3% YoY to Rs22.9b was driven by volume growth of 28.3% YoY and improvement in realizations by 3.1%.

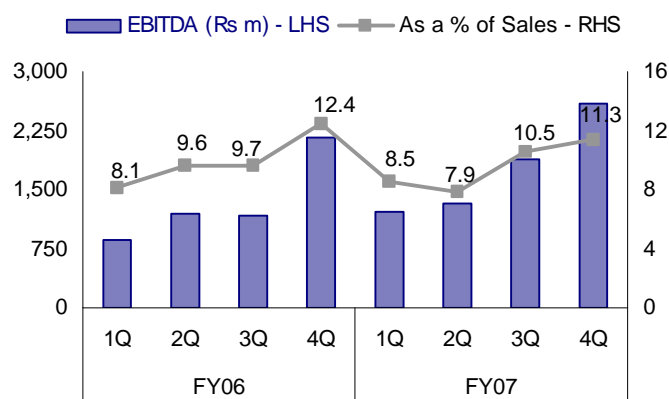
Adj. EBITDA margins declined to 11.3% (-110bp YoY but +80bp QoQ), while EBITDA was Rs2.6b (adj. for forex gain of Rs53.8m). Margins have been hampered by higher staff costs (5.1% of sales v/s 4.7% in 4QFY06) and higher other expenditure (9.1% v/s 8.7% in 4QFY06). In spite of the rise in raw-material prices, RM/sales ratio was maintained at 74.5% (+40bp YoY and +10bp QoQ).

Depreciation increased by 45.8% due to ongoing capacity expansion. As a result, Ashok Leyland reported 28% growth in adjusted PAT to Rs1.7b.

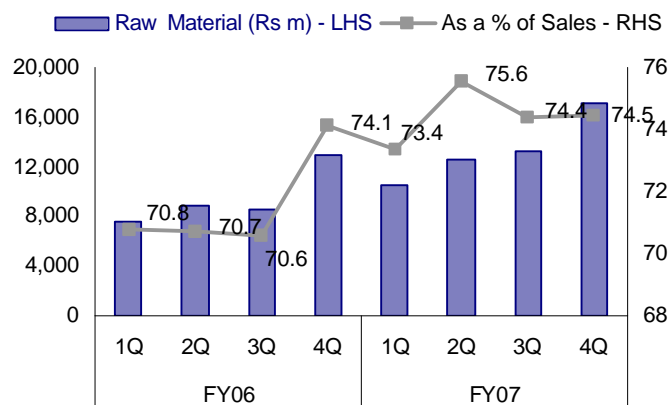
For the full year FY07, ALL reported 36.6% increase in net sales to Rs71.7b. EBITDA margin was 9.8% (v/s 10.2%

in FY06) as EBITDA increased 30.3% to Rs7b. Adj. PAT increased 41.4% to Rs4.3b.

#### EBITDA MARGIN: BELOW EXPECTATIONS



#### RAW MATERIALS COSTS ARE FLAT



Source: Company/Motilal Oswal Securities

### Investment argument

We believe structural factors for the CV industry are still in place. We expect ALL's volumes to grow by 12.5% in FY08 and by 9% in FY09. Its focus on non-cyclical business segments such as vehicle and aggregate exports is expected to cushion domestic business cyclicality. The quality of earnings and earnings momentum for ALL is expected to improve in the coming quarters, aided by capacity addition and stable EBITDA margin.

### Share of non-cyclical revenue to increase dramatically

ALL has been making continuous efforts to broaden its revenues by focusing on the passenger bus segment, sale of spare parts, exports and supplies to defense – all of which are non-cyclical segments. The company plans to increase the share of non-cyclicals to more than 35% of revenues by FY09.

### Avia acquisition to boost exports

Ashok Leyland has acquired Avia's truck business, which will give it a foothold in Eastern Europe. Avia's truck manufacturing facility has a capacity of 20,000 units. Besides boosting exports, Avia's acquisition would also help Ashok Leyland gain a presence in ICVs (7 ton-11 ton). Ashok Leyland expects exports to constitute 20% of its total volumes by FY10, up from the 7% in FY07.

### Increasing presence in engineering and design services

ALL is also to acquire Detroit-based testing services firm Defiance Testing and Engineering Services for US\$17m, which will complement ALL's design and engineering services division and help the segment target value-added business.

### Valuation and view

We remain positive on Ashok Leyland's growth prospects. We expect volumes to grow by 12.5% in FY08 and by 9% in FY09.

We have reduced our estimates downwards to factor higher depreciation and have also moderated our margin assumptions by 60bp for FY08 and FY09. As compared to the 9.8% EBITDA margin in FY07, we expect margins of 10% and 10.2% in FY08 and FY09 respectively. This has resulted in our EPS estimate for FY08 reducing by 3.8% and that for FY09 reducing by 3.6%. The stock is trading at 10.5x FY08 revised EPS of Rs3.8 and 9.2x FY09 revised EPS of Rs4.3. Maintain **Buy**.

## Ashok Leyland: an investment profile

### Company description

Ashok Leyland is the second largest commercial vehicle manufacturer in India with a product portfolio comprising of passenger and goods carriers across all tonnage categories. An erstwhile regionally concentrated CV company, Ashok Leyland has made serious attempts in the last 12 months to broad base its markets to include not only northern India but also South East Asia.

### Key investment arguments

- ✍ We remain positive on the growth rate for the CV segment, due to strong industrial growth and increased focus of the Government on highway development.
- ✍ While ramping up its installed capacity, ALL is also focusing on programs like e-sourcing, which will enable it attain stable operating margin in a rising cost scenario.
- ✍ ALL's focus on non-cyclical business segments such as vehicle and aggregate exports is expected to cushion domestic business cyclicality.

### Key investment risks

- ✍ Increased competition with several MNC players such as ITEC and MAN entering the Indian market.
- ✍ Further increases in interest rates may impact demand negatively.

### Recent developments

- ✍ Freight rates have remained stable after recording a rapid 17% increase in FY07.
- ✍ ALL is also to acquire Detroit based testing services firm Defiance Testing and Engineering Services for US\$17m.

### Valuation and view

- ✍ We expect volumes to grow by 12.5% in FY08 and by 9% in FY09.
- ✍ We have revised our estimates downwards, mainly on account of higher than expected depreciation and to account for lower EBITDA margins. The stock trades at 10.5x FY08 revised EPS of Rs3.8 and 9.2x FY09 revised EPS of Rs4.3. We maintain **Buy** with a target price of Rs52.

### Sector view

- ✍ Demand related factor of IIP production remain strong for the sector.
- ✍ Freight rates have remained firm, quelling any near term fears.
- ✍ We maintain a positive but cautious stance on the sector.

#### COMPARATIVE VALUATIONS

		ASHOK LEY	TATA MOTORS
P/E (x)	FY08E	10.5	11.2
	FY09E	9.2	9.9
EPS Gr (%)	FY08E	16.8	11.8
	FY09E	13.9	13.0
RoE (%)	FY08E	26.4	26.5
	FY09E	26.1	24.5
EV/EBITDA (x)	FY08E	5.4	6.9
	FY09E	4.4	6.1

#### SHAREHOLDING PATTERN (%)

	MAR.07	DEC.06	MAR.06
Promoter	38.9	38.9	49.6
Domestic Inst	20.5	20.3	19.3
Foreign	26.1	26.2	17.8
Others	14.5	14.6	13.3

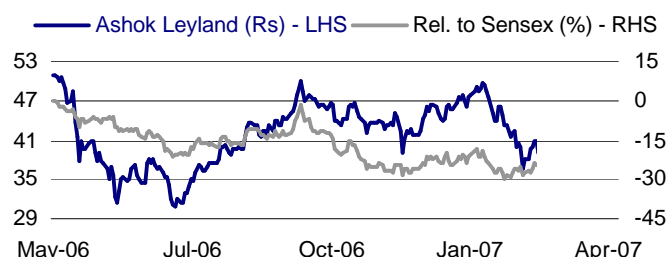
#### EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	3.8	3.6	6.4
FY09	4.3	4.0	6.4

#### TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
40	52	31.6	Buy

#### STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
<b>Net Sales</b>	<b>41,824</b>	<b>52,477</b>	<b>71,682</b>	<b>81,198</b>	<b>89,310</b>	
Change (%)	23.3	25.5	36.6	13.3	10.0	
Expenditure	37,595	47,108	64,685	73,106	80,231	
<b>EBITDA</b>	<b>4,228</b>	<b>5,369</b>	<b>6,997</b>	<b>8,092</b>	<b>9,079</b>	
Change (%)	7.2	27.0	30.3	15.7	12.2	
% of Net Sales	10.1	10.2	9.8	10.0	10.2	
Depreciation	1,092	1,260	1,506	1,633	1,701	
Interest & Finance Charg	304	384	53	45	38	
Other Income	554	549	470	546	589	
Non-recurring Expense	95	85	131	-	-	
Non-recurring Income	260	334	268	-	-	
<b>PBT</b>	<b>3,386</b>	<b>4,274</b>	<b>5,908</b>	<b>6,960</b>	<b>7,930</b>	
Tax	836	1,250	1,632	1,966	2,240	
Effective Rate (%)	24.7	29.2	27.6	28.3	28.3	
<b>Adj. PAT (bef. Extra</b>	<b>2,550</b>	<b>3,024</b>	<b>4,276</b>	<b>4,994</b>	<b>5,689</b>	
% of Net Sales	25.6	18.6	41.4	16.8	13.9	
<b>Rep. PAT</b>	<b>2,715</b>	<b>3,273</b>	<b>4,413</b>	<b>4,994</b>	<b>5,689</b>	

BALANCE SHEET		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
Share Capital	1,189	1,222	1,324	1,324	1,324	
Reserves	10,489	12,903	15,109	17,606	20,451	
<b>Net Worth</b>	<b>11,679</b>	<b>14,125</b>	<b>16,433</b>	<b>18,930</b>	<b>21,774</b>	
Loans	8,804	6,919	6,169	4,919	4,419	
Deferred Tax Liability	1,708	1,797	1,797	1,797	1,797	
<b>Capital Employed</b>	<b>22,191</b>	<b>22,841</b>	<b>24,399</b>	<b>25,646</b>	<b>27,991</b>	
Gross Fixed Assets	20,023	21,385	24,199	25,249	26,249	
Less: Depreciation	11,084	11,952	13,458	15,091	16,792	
<b>Net Fixed Assets</b>	<b>8,938</b>	<b>9,433</b>	<b>10,741</b>	<b>10,158</b>	<b>9,457</b>	
Investments	2,292	3,682	3,682	3,682	3,682	
<b>Curr.Assets, L &amp; Ad<sup>v</sup></b>	<b>21,573</b>	<b>22,324</b>	<b>25,454</b>	<b>29,109</b>	<b>33,711</b>	
Inventory	5,681	9,026	10,801	12,235	13,458	
Sundry Debtors	4,588	4,243	5,892	6,674	7,341	
Cash & Bank Balances	7,967	6,029	8,571	10,010	12,723	
Loans & Advances	3,337	3,026	190	190	190	
<b>Current Liab. &amp; Prov</b>	<b>11,657</b>	<b>14,085</b>	<b>15,551</b>	<b>17,376</b>	<b>18,932</b>	
Sundry Creditors	8,619	10,460	13,747	15,572	17,128	
Other Liabilities	993	1,009	1,009	1,009	1,009	
Provisions	2,045	2,616	794	794	794	
<b>Net Current Assets</b>	<b>9,916</b>	<b>8,239</b>	<b>9,903</b>	<b>11,733</b>	<b>14,779</b>	
Miscellaneous Exp.	193	73	73	73	73	
<b>Application of Fund:</b>	<b>22,191</b>	<b>22,841</b>	<b>24,399</b>	<b>25,646</b>	<b>27,991</b>	

E: MOST Estimates

RATIOS						
Y/E MARCH	2005	2006	2007	2008E	2009E	
<b>Basic (Rs)</b>						
<b>EPS</b>	<b>1.9</b>	<b>2.5</b>	<b>3.2</b>	<b>3.8</b>	<b>4.3</b>	
Cash EPS	3.1	3.5	4.4	5.0	5.6	
EPS Growth (%)	17.2	29.7	30.5	16.8	13.9	
Book Value per Share	9.8	11.6	12.4	14.3	16.4	
DPS	10	13	18	2.0	2.3	
Payout (Incl. Div. Tax) %	48.7	48.8	50.0	50.0	50.0	
<b>Valuation (x)</b>						
P/E		16.0	12.2	10.5	9.2	
Cash P/E		11.3	9.0	7.9	7.1	
EV/EBITDA		8.5	6.6	5.4	4.4	
EV/Sales		0.9	0.6	0.5	0.5	
Price to Book Value		3.4	3.2	2.8	2.4	
Dividend Yield (%)		3.3	4.6	5.2	5.9	
<b>Profitability Ratios (%)</b>						
RoE	23.2	23.2	26.9	26.4	26.1	
RoCE	16.6	20.4	24.4	27.3	28.5	
<b>Leverage Ratio</b>						
Debt/Equity (x)	0.8	0.5	0.4	0.3	0.2	

CASH FLOW STATEMENT		(Rs Million)				
Y/E MARCH	2005	2006	2007	2008E	2009E	
OP/(Loss) before Tax	3,136	4,109	5,491	6,459	7,378	
Depreciation & Amortise	1,092	1,260	1,506	1,633	1,701	
Direct Taxes Paid	-930	-1,161	-1,632	-1,966	-2,240	
(Inc)/Dec in Working Cap	1,241	-141	741	-391	-333	
Other Items	-365	738	137	0	0	
<b>CF from Oper. Activ</b>	<b>4,174</b>	<b>4,805</b>	<b>6,243</b>	<b>5,735</b>	<b>6,506</b>	
Extra-ordinary Items	165	249	137	0	0	
<b>CF after EO Items</b>	<b>4,339</b>	<b>5,054</b>	<b>6,380</b>	<b>5,735</b>	<b>6,506</b>	
(Inc)/Dec in FA+CWIP	-1,671	-2,317	-1,400	-1,050	-1,000	
(Pur)/Sale of Invest.	-826	-1,390	0	0	0	
<b>CF from Inv. Activit<sup>y</sup></b>	<b>-2,497</b>	<b>-3,707</b>	<b>-1,400</b>	<b>-1,050</b>	<b>-1,000</b>	
Issue of Shares	0	32	102	0	0	
Inc/(Dec) in Debt	3,815	-1,885	-750	-1,250	-500	
Interest Rec./(Paid)	250	165	417	501	551	
Dividends Paid	-1,189	-1,598	-2,206	-2,497	-2,845	
<b>CF from Fin. Activit<sup>y</sup></b>	<b>2,875</b>	<b>-3,285</b>	<b>-2,438</b>	<b>-3,246</b>	<b>-2,793</b>	
<b>Inc/(Dec) in Cash</b>	<b>4,717</b>	<b>-1,938</b>	<b>2,543</b>	<b>1,439</b>	<b>2,712</b>	
Add: Beginning Balance	3,250	7,967	6,029	8,571	10,010	
<b>Closing Balance</b>	<b>7,967</b>	<b>6,029</b>	<b>8,571</b>	<b>10,010</b>	<b>12,723</b>	



For more copies or other information, contact

**Institutional:** Navin Agarwal. **Retail:** Manish Shah

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

**Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021**

This report is for the personal information of the authorized recipient and does not construe to be any investment, legal or taxation advice to you. Motilal Oswal Securities Limited (*hereinafter referred as MOST*) is not soliciting any action based upon it. This report is not for public distribution and has been furnished to you solely for your information and should not be reproduced or redistributed to any other person in any form.

The report is based upon information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied upon such. MOST or any of its affiliates or employees shall not be in any way responsible for any loss or damage that may arise to any person from any inadvertent error in the information contained in this report. MOST or any of its affiliates or employees do not provide, at any time, any express or implied warranty of any kind, regarding any matter pertaining to this report, including without limitation the implied warranties of merchantability, fitness for a particular purpose, and non-infringement. The recipients of this report should rely on their own investigations.

MOST and/or its affiliates and/or employees may have interests/ positions, financial or otherwise in the securities mentioned in this report. To enhance transparency, MOST has incorporated a Disclosure of Interest Statement in this document. This should, however, not be treated as endorsement of the views expressed in the report.

**Disclosure of Interest Statement**

**Ashok Leyland**

- |   |    |
|---|----|
| 1. Analyst ownership of the stock                       | No |
| 2. Group/Directors ownership of the stock               | No |
| 3. Broking relationship with company covered            | No |
| 4. Investment Banking relationship with company covered | No |

This information is subject to change without any prior notice. MOST reserves the right to make modifications and alternations to this statement as may be required from time to time. Nevertheless, MOST is committed to providing independent and transparent recommendations to its clients, and would be happy to provide information in response to specific client queries.