

29 January 2008

Buy

Price	Target Price
Rs 37	Rs54

Sensex – 18153

Price Performance

(%)	1M	3M	6M	12M
Absolute	(27)	(8)	(1)	(23)
Rel. to Sensex	(19)	(3)	(16)	(39)

Source: Bloomberg

Stock Details

Sector	Automobiles
Reuters	ASOK.BO
Bloomberg	AL@IN
Equity Capital (Rs mn)	1330
Face Value (Rs)	1
52 Week H/L (Rs)	58/26
Market Cap (Rs bn)	49
Daily Avg Vol (No of shares)	18243520
Daily Avg Turnover (US\$ mn)	21.9

Shareholding Pattern (%)

(30th Sep.'07)

Promoters	51.0
FII/NRI	17.2
Institutions	15.9
Private Corp.	3.4
Public	12.5

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In line with expectations...

Ashok Leyland reported its 3QFY08 numbers. Volumes declined by 5.5% YoY to 18965 units. However, net sales grew by 1.3% YoY to Rs 18 bn backed by spare parts and defence sales and approximately 4% pricing action during preceding 12 months. However, EBIDTA has registered a decline by 10% YoY to Rs 1.7 bn. This is largely due to significant increase in the employee cost, which increased by 29% YoY on account of employee addition as well as wage revisions. Infact, increase in wage costs overshadowed the efforts of the company on the raw material ans well as other expenses front. Higher depreciation charge and rising interest costs resulted in adjusted net profits to decline by 17.5% YoY to Rs 916 mn.

The results were in line with our expectations. We have adjusted our estimates to factor in aggressive employee addition and better than expected productivity improvement. Also, we have introduced FY10 estimates. At Rs 37, the stock trades at PER of 9.3 times and 8.3 times our FY09 and FY10 EPS of Rs 4 and 4.5 respectively. Post the recent correction in the stock price, we believe that the valuations have turned attractive. We upgrade our recommendation from **HOLD** to **BUY**.

Spare parts and defense business drives the growth

Despite a decline of 5.5% YoY in volumes to 18965, the revenues increased by 1.3% YoY to Rs 18 bn. The growth can be attributed to pricing action (approx 4%) undertaken by the company during the preceding 12 months and higher spare parts and defense sales. Infact, the spare parts and defense sales, increased by 13% YoY to Rs 2 bn. Also higher sales of passenger carriers compensated for decline sales of high tonnage goods vehicles (> 16 Tonnes). Average realization improved by 6% YoY to Rs 843175.

Product mix %	3QFY08	3QFY07	2QFY08
Goods Carriers			
upto 16 t	28.2	24.1	29.3
> 16 t	71.8	75.9	70.7
Total	100.0	100.0	100.0
Passenger Carriers			
Passenger Carriers	27.4	22.3	35.7
Goods Carriers	72.6	77.7	64.3
Total	100.0	100.0	100.0

Rise in employee costs overshadows the results of productivity and efficiency gains

EBIDTA declined by 10% YoY to 1.7 bn. EBIDTA margins declined by 110 bps YoY to 9.4%. The fall in EBIDTA margins is largely attributable to significant increase in the staff costs, which increased by 29% YoY to Rs 1.5 bn (as a % of sales, staff cost increased by 170 bps YoY to 8.2%). There has been an employee addition to the tune of 600 people (largely in the executive category) for the existing operations as well as greenfield expansion plan at Uttarkhand. Also, there has been wage revision during 4QFY07. Having said that, the benefits of productivity improving program (Mission Gemba), appears to start yielding results as is evident from the control on raw material as well as other expenses.

One time income props up the bottom-line

During the quarter, the company further reduced its stake in IndusInd bank by 1% to 8.94%, resulting in a gain of Rs 330 mn. As a result, the net profits grew by 14% YoY to 1.2 bn. However, adjusting for this income the net profits have declined by 17.5% YoY to Rs 916 mn, which is 3% lower than our estimates, primarily due to higher staff expenses.

Introducing FY10 numbers

We have introduced our FY10 estimates. On the industry front we expect the domestic M&HCV industry to grow by 6.7% YoY to 328,000 units and exports to grow by 12.5% YoY to 31,400 units. Overall, we have factored in 7.2% YoY growth in the M&HCV industry to 359,400 units.

For Ashok Leyland, we expect the to report 8.2% YoY growth to 96800 units in domestic market and 20% growth in exports to 9500 units. We expect the company to improve its market share from 28.3% in FY08 to 29.5% in FY10 in the domestic market.

We believe that there is a high probability of out-performance in the bus segment, considering the fact that the company has a strong presence amongst STUs and there is an expectation of steady demand from STUs in Andra Pradesh, Tamil Nadu, Karnataka, Haryana and UP.

Valuation and View

We have been conservative in our volume forecast estimates considering the potential triggers that exist for the M&HCV segment with respect to stringent implementation of overloading ban as well as implementation of BS III norms in 2010 and the underlying strength of the Indian economy. Also, we would like to highlight the fact that going ahead, the volume growth may not be right indicators of the actual growth due significant rise in the demand for higher tonnage vehicles. Having said that, we would prefer to witness the turnaround before factoring in higher volume/tonnage growth

At Rs 37, the stock trades at PER of 9.3 times and 8.3 times our FY09 and FY10 EPS of Rs 4 and 4.5 respectively. Post the recent correction in the stock price, we believe that the valuations have turned attractive. We upgrade our recommendation from **HOLD** to **BUY**.

<i>Rs mn</i>	3QFY07	3QFY08	% change	9MFY07	9MFY08	% change
Net Sales	17,776	18,001	1.3	48,772	51,671	5.9
Operating Expenses						
Raw Materials	13,554	13,590	0.3	37,225	38,730	4.0
<i>% of Sales</i>	76.2	75.5		76.3	75.0	
Staff Costs	1,149	1,478	28.6	3,644	4,488	23.2
<i>% of Sales</i>	6.5	8.2		7.5	8.7	
Other Expenses	1,205	1,245	3.4	3,501	3,581	2.3
<i>% of Sales</i>	6.8	6.9		7.2	6.9	
EBIDTA	1,869	1,687	-9.7	4,402	4,872	10.7
EBIDTA %	10.5	9.4		9.0	9.4	
Depreciation	332	408	22.9	1,024	1,287	25.7
EBIT	1,536	1,279	-16.8	3,377	3,584	6.1
Other Income	64	107	68.5	309	294	-4.9
Interest	26	152	494.5	35	406	1,076.7
PBT	1,574	1,233	-21.7	3,652	3,472	-4.9
Forex gain/(loss)	-28	-33		-24	210	
Extraordinary inc/(exp)	-31	317		130	256	
Tax	463	316	-31.7	1,059	1,051	-0.7
Net Profit	1,053	1,201	14.1	2,698	2,887	7.0
<i>Net Margin %</i>	5.9	6.7		5.5	5.6	
Adjusted Net Profit	1,110	916	-17.5	2,574	2,463	-4.3
<i>Adjusted Net Margin %</i>	6.2	5.1		5.3	4.8	
EPS	0.8	0.9	12.4	2.1	2.2	5.3
Adjusted EPS	0.8	0.7	-18.7	2.0	1.9	-5.8

Quarterly and annual results summary

Profit & Loss Account - Standalone					Balance Sheet - Standalone				
Mar ending (Rs mn)	FY07	FY08E	FY09E	FY10E	Mar ending (Rs mn)	FY07	FY08E	FY09E	FY10E
Net Sales	73,389	80,384	93,601	106,375	Share Capital	1,324	1,331	1,331	1,331
<i>Growth %</i>	36.8	9.5	16.4	13.6	Reserves	17,622	19,943	22,469	25,375
Operating Expenses					Misc Exp	-244	-244	-244	-244
Raw Materials	54,633	59,183	69,064	78,295	Owned Funds	18,702	21,030	23,556	26,462
<i>% of Sales</i>	74.4	73.6	73.8	73.6	Secured Loans	3,602	3,402	3,085	2,769
Staff Costs	4,807	6,355	7,174	8,315	Unsecured Loans	2,802	10,412	10,272	10,551
<i>% of Sales</i>	6.6	7.9	7.7	7.8	Loan Funds	6,404	13,814	13,358	13,320
Other Expenses	6,922	7,216	8,015	9,388	Deferred Tax Liability	1,969	1,969	1,969	1,969
<i>% of Sales</i>	9.4	9.0	8.6	8.8	Total	27,075	36,813	38,883	41,751
EBIDTA	7,027	7,630	9,348	10,377	Gross Fixed Assets	26,202	32,702	37,202	41,702
<i>Growth %</i>	30.1	8.6	22.5	11.0	Acc. Depreciation	13,132	14,953	17,111	19,530
EBIDTA %	9.6	9.5	10.0	9.8	Net Fixed Assets	13,070	17,749	20,091	22,172
Depreciation	1,506	1,821	2,158	2,419	Capital WIP	2,375	3,500	3,000	3,000
EBIT	5,521	5,809	7,190	7,958	Net Block	15,445	21,249	23,091	25,172
Other Income	743	795	840	875	Investments	2,211	2,811	3,211	3,411
Interest	318	622	668	559	Sundry Debtors	5,229	7,245	10,093	11,127
PBT	5,946	5,982	7,362	8,273	Inventory	10,703	12,165	14,165	15,762
Extraordinary inc/(exp)	99	330	0	0	Cash & Bank	4,349	4,268	1,483	1,064
Tax	1,632	1,645	2,025	2,275	Advances	6,696	7,628	8,325	9,694
Net Profit	4,413	4,667	5,338	5,998	Current Assets	26,977	31,306	34,065	37,647
<i>Net Margin %</i>	6.0	5.8	5.7	5.6	Liabilities	16,516	16,733	19,378	22,080
<i>Growth %</i>	34.8	5.8	14.4	12.4	Provisions	1,042	1,819	2,106	2,400
EPS	3.3	3.5	4.0	4.5	Current Liabilities	17,559	18,552	21,484	24,480
Adjusted EPS	3.3	3.3	4.0	4.5	Net Current Assets	9,419	12,753	12,581	13,168
Adjusted CEPS	4.4	4.6	5.6	6.3	Total	27,075	36,813	38,883	41,751

Source: Emkay Research

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Cash Flow

Mar ending (Rs mn)	FY07	FY08E	FY09E	FY10E
Net Profit before tax	5,946	5,982	7,362	8,273
Add: Depreciation	1,506	1,821	2,158	2,419
Add: Interest	318	622	668	559
Less: Other income	743	795	840	875
(Dec)/Inc in Working capital	(372)	3,416	2,613	1,005
Less: Tax paid	1,356	1,645	2,025	2,275
Cash from operations	5,000	2,569	4,710	7,096
Capex	(6,704)	(7,625)	(4,000)	(4,500)
Investments and others	(1,535)	(600)	(400)	(200)
Other income	743	795	840	875
Cash from Investing activities	(7,497)	(7,430)	(3,560)	(3,825)
Borrowings	1,332	7,627	(457)	(38)
Interest paid	(169)	(622)	(668)	(559)
Dividend paid	(4,057)	(2,556)	(2,811)	(3,092)
Cash from financing activities	(2,894)	4,450	(3,936)	(3,690)
Cash generation during the year	(5,391)	(407)	(2,785)	(419)
Opening Balance*	8,503	4,349	4,268	1,483
Closing Balance*	3,112	3,938	1,483	1,064

* Represents cash and cash equivalents for FY06 and FY07

Source: Emkay Research

Ratios

Mar ending (Rs mn)	FY07	FY08E	FY09E	FY10E
Per Share Data				
Adj EPS	3.3	3.3	4.0	4.5
Adj CEPS	4.4	4.6	5.6	6.3
BVPS	14.1	15.8	17.7	19.9
Valuation ratio				
P/E	11.3	11.4	9.2	8.2
Cash P/E	8.4	8.0	6.6	5.9
P/BV	2.6	2.3	2.1	1.9
EV/EBIDTA	6.9	7.3	6.2	5.6
Return Ratios (%)				
AROE	26.9	23.5	23.9	24.0
AROCE	23.7	20.3	19.8	20.9
Dupont				
NPM (%)	6.0	5.8	5.7	5.6
Sales/TA	1.6	1.5	1.6	1.6
TA/Equity	2.4	2.6	2.6	2.5
Other key ratios				
D/E	0.3	0.7	0.6	0.5
NWC/Sales (%)	6.9	10.6	11.9	11.4

Source: Emkay Research

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