8 September 2008 | 8 pages

Ashok Leyland (ASOK.BO)

Sell: ASOK-Nissan JV – Penning the Short Strokes

- **What's new?** — The ASOK-Nissan LCV JV has signed an MOU with the Government of Tamil Nadu to acquire 380 acres of land to set up vehicle, powertrain manufacturing facilities and a technology development unit near Chennai. The JV will have an initial installed capacity of 100,000 units – vehicle launch is targeted in 2010-11. Exports are forecast to account for 20% of the first phase of initial capacity.

- **Capex details** — The company will incur a total investment of Rs40 billion for the total project. The operations will enjoy a 21-year VAT concession; investments will be staggered over a 7-8 year period. These investments will create integrated facilities for engines, gear boxes, press shops, chassis and parts.

- **Mutually beneficial alliance** — ASOK gets access to Nissan's engine/ powertrain and product technologies. Nissan gets access to the Indian market. We think that it might also be able to utilize ASOK's distribution network and vendor base. The ASOK-Nissan venture will have a complete product range spanning the light truck market, with payloads ranging from 0.35-4MT.

- **Reiterate Sell (3L)** — Risk-reward ratio currently appears unattractive on ALL. Burgeoning capital outlay on various initiatives is a concern. Reiterate Sell (3L). Key upside risks - a) a sharper than expected growth in HCV volumes over FY09E, b) decline in material costs and rebound in margins.

Sell/Low Risk	**3L**
Price (08 Sep 08)	Rs32.70
Target price	Rs26.00
Expected share price return	-20.5%
Expected dividend yield	3.1%
Expected total return	**-17.4%**
Market Cap	Rs43,502M
	US$974M

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

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2007A	4,579	3.46	48.8	9.5	2.3	27.7	4.6
2008A	4,787	3.60	4.0	9.1	2.0	23.7	4.6
2009E	3,842	2.89	-19.7	11.3	1.8	17.0	3.1
2010E	3,429	2.58	-10.7	12.7	1.7	13.8	3.1
2011E	4,176	3.14	21.8	10.4	1.5	15.4	3.1

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Markets India Private Limited

Fiscal year end 31-Mar	2007	2008	2009E	2010E	2011E
Valuation Ratios					
P/E adjusted (x)	9.5	9.1	11.3	12.7	10.4
EV/EBITDA adjusted (x)	6.0	5.3	6.7	7.7	6.5
P/BV (x)	2.3	2.0	1.8	1.7	1.5
Dividend yield (%)	4.6	4.6	3.1	3.1	3.1
Per Share Data (Rs)					
EPS adjusted	3.46	3.60	2.89	2.58	3.14
EPS reported	3.53	3.53	2.89	2.58	3.14
BVPS	14.31	16.15	17.90	19.33	21.32
DPS	1.49	1.50	1.00	1.00	1.00
Profit & Loss (RsM)					
Net sales	71,682	77,291	83,553	93,575	106,287
Operating expenses	-66,161	-71,025	-78,174	-88,274	-99,482
EBIT	**5,521**	**6,266**	**5,379**	**5,301**	**6,805**
Net interest expense	-288	-763	-919	-1,441	-1,745
Non-operating/exceptionals	1,074	878	804	805	583
Pre-tax profit	**6,307**	**6,382**	**5,263**	**4,666**	**5,643**
Tax	-1,632	-1,688	-1,421	-1,236	-1,467
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**4,674**	**4,693**	**3,842**	**3,429**	**4,176**
Adjusted earnings	4,579	4,787	3,842	3,429	4,176
Adjusted EBITDA	7,027	8,040	7,332	7,721	9,831
Growth Rates (%)					
Sales	36.6	7.8	8.1	12.0	13.6
EBIT adjusted	33.3	13.5	-14.2	-1.4	28.4
EBITDA adjusted	30.1	14.4	-8.8	5.3	27.3
EPS adjusted	48.8	4.0	-19.7	-10.7	21.8
Cash Flow (RsM)					
Operating cash flow	**4,668**	**8,876**	**5,986**	**5,849**	**7,202**
Depreciation/amortization	1,506	1,774	1,953	2,420	3,026
Net working capital	-2,455	1,403	-614	0	0
Investing cash flow	**4,455**	**205**	**315**	**316**	**317**
Capital expenditure	0	0	0	0	0
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**391**	**328**	**14,166**	**8,507**	**3,683**
Borrowings	-515	2,471	15,683	8,507	3,683
Dividends paid	-2,264	-2,337	-1,517	0	0
Change in cash	**9,514**	**9,408**	**20,467**	**14,672**	**11,202**
Balance Sheet (RsM)					
Total assets	**44,878**	**55,622**	**75,035**	**87,888**	**97,122**
Cash & cash equivalent	4,349	4,514	2,815	1,000	1,000
Accounts receivable	5,229	3,758	4,859	5,435	6,152
Net fixed assets	15,445	20,548	36,595	46,175	49,148
Total liabilities	**25,932**	**34,133**	**51,226**	**62,173**	**68,754**
Accounts payable	14,337	17,351	18,802	21,134	23,717
Total Debt	6,404	8,875	24,558	33,066	36,749
Shareholders' funds	**18,946**	**21,490**	**23,809**	**25,715**	**28,368**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	9.8	10.4	8.8	8.3	9.2
ROE adjusted	27.7	23.7	17.0	13.8	15.4
ROIC adjusted	23.0	21.3	12.9	9.3	10.7
Net debt to equity	10.8	20.3	91.3	124.7	126.0
Total debt to capital	25.3	29.2	50.8	56.3	56.4

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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 maintain our Sell/Low Risk (3L) rating because growth prospects for ALL appear limited, and a rising capital outlay poses risks. At current prices, we believe the stock factors in most of the visible positives. Fundamentally, the key reasons for a healthy growth outlook in commercial vehicles include 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 near term looks challenging for Ashok Leyland due to sharp increase in interest rates, which will affect demand. A slowdown in the economy will also lead to a slowdown in the investment cycle, which will have an impact on Ashok Leyland's profitability.

Valuation

Our 12-month target price of Rs26 for ALL is based on 6x Sep09E CEPS (revised from 7x Mar 09 CEPS), close to the lower end of the stock's 4-year historical trading band of 6-9x to reflect slower-than-expected earnings growth due to margin pressure and higher capital costs. We prefer to use P/CEPS as a valuation metric to ensure proper comparison with historical trading bands, and reflect a restructuring of the balance sheet in FY03 and the capital-intensive nature of the business. At our target price, the stock would trade at a P/E of 10.5x FY10E EPS, at the lower end of its recent trading band.

Risks

We rate ALL Low Risk based on our quantitative risk-rating system, which tracks 260-day historical share-price volatility. 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 on account of the Supreme Court ruling on overloading; 2) Reduction in input costs (notably steel and aluminium) would benefit earnings; and 3) Effective integration of the Avia acquisition could enable ALL to penetrate the domestic LCV market succesfully.

Appendix A-1

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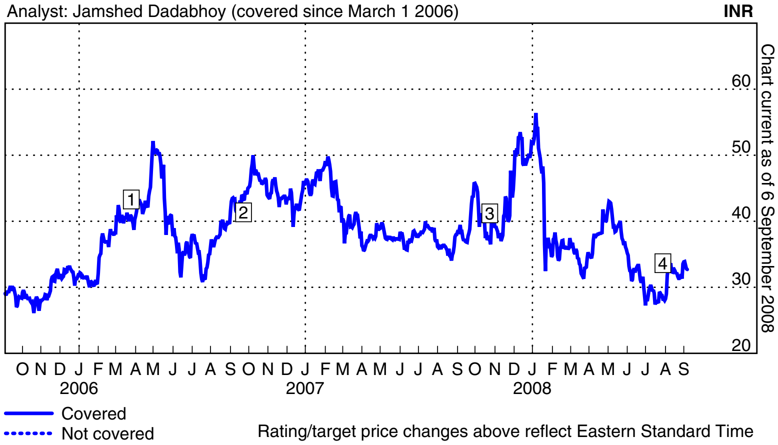
Ashok Leyland (ASOK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoy (covered since March 1 2006)



#	Date	Rating	Target Price	Closing Price
1:	26 Mar 06	*3L	*37.00	40.75
2:	22 Sep 06	3L	*39.00	43.30
3:	24 Oct 07	3L	*38.00	37.15
4:	29 Jul 08	3L	*26.00	28.20

*Indicates change.

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