

Company Flash

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Ashok Leyland (ASOK.BO)

Dec Sales – Strong Volumes Growth

- Robust December sales** — Up c30% YoY, driven by strong MHCV goods volumes (+43% yoy). Bus sales continue to remain sedate (+c6% YoY, dragged down by exports) – domestic bus sales rose c16% - in line with management's indication that bus orders from STUs (~3000 units) would be executed into end 3Q / 4Q.
- Goods vehicles drive growth** — Domestic HCV goods volumes have risen c60% YTD, + 81% YoY for 3Q. Unit sales declined c19% MoM – management attributed this to Tamil Nadu shifting to a VAT regime (from Jan 07), which resulted in deferment of volumes into 4QFY07
- Robust FY08E industry outlook** — ALL's CFO stated (in an interview with CNBC) that CV volumes could grow at ~10-15% over FY08E (vs our current estimate of 6% growth). However, within heavier classes of trucks (multi axle vehicles and tractor trailers), ALL expects growth to remain extremely robust - around 25% and over
- Concerns on margin pressure continue** — We expect 3Q EBITDA margins to be impacted significantly by a) higher material costs, b) a pronounced shift toward trucks (margins are slightly lower in trucks than buses), and c) discounts offered (~5-8% on list price of vehicles in Oct / Nov 06)
- Retain Sell/Low Risk** — Current valuations appear stretched and factor in near term positives. Key upside risks to our forecasts are a) a sharper than expected growth in HCV volumes, b) decline in interest rates, c) decline in material costs

Sell/Low Risk	3L
Price (05 Jan 07)	Rs46.35
Target price	Rs39.00
Expected share price return	-15.9%
Expected dividend yield	3.2%
Expected total return	-12.6%
Market Cap	Rs61,335M US\$1,389M

Figure 1. December 2006 Sales

	Dec-06 Nos	% chg YoY	% chg over Nov	FY07 YTD (Nos)	% chg YoY
MDV passenger	1,450	6.3	-0.9	10,403	-10.6
MDV goods	4,418	43.0	-18.8	46,311	59.6
LCV	22	-75.8	4.8	257	-56.9
Total	5,890	29.6	-14.9	56,971	38.1

Source: Citigroup Investment Research

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See page 3 for Analyst Certification and important disclosures.

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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 thesis

We have a Sell rating on ALL – valuations being the primary concern. We believe the stock currently prices in all positives. Fundamentally, key reasons for a healthy growth outlook in commercial vehicles include a sustained pick-up in economic activity, a focus on infrastructure spending and a strong replacement cycle (27% 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. ALL is raising capacity by c30% over the next two years to meet demand, and plans to launch new products. In the long term, exports could emerge as a growth driver as ALL leverages off its low-cost competitive advantage to enter foreign markets.

Valuation

Our 12-month target price of Rs39 for ALL is based on 8.55x FY08E cash earnings. Our target multiple is at a 20% discount to the multiple we assign to Tata Motors, which we believe, correctly reflects ALL's substantially smaller scale of operations and less diversified revenue profile. (ALL is not present in passenger cars or utility vehicles and has an extremely modest presence in light commercial vehicles.) A c18% CAGR in cash earnings over FY06-08E should support these valuations. We prefer to use P/CEPS as a valuation metric to ensure proper comparison with historical trading bands, 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 13x FY07E EPS, in the middle of its recent trading band. This is well supported by a 20% CAGR in earnings over FY06-08E.

Risk

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 is an important risk factor, given that the STUs are the largest buyers of ALL buses. Key upside risks: 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; 3) Effective integration of the Avia acquisition could enable ALL to successfully penetrate the domestic LCV market.

Analyst Certification Appendix A-1

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Ashok Leyland (ASOK.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoj (covered since March 1 2006)



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