



## RESEARCH

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## Expensive on muted prospects

## Raise forecasts, but retain rating

Q4 results were ahead of expectations, thanks to control over key expense items. Still, operational EBITDA, declined 70% to Rs908mn (BAS-MLe Rs648mn), and high interest outgo restricted recurring net profit to Rs269mn (Rs476mn). As a result, FY09 EBITDA declined 40% to Rs4.69bn (BAS-MLe Rs3.90bn), and net profit Rs2.02bn (Rs1.50bn). We raise forecasts to reflect this surprise. However, re-iterate Underperform on weak prospects, and expensive valuations.

## Margin surprise

Q4 margins at 7.5% (down 450bps yoy) was driven by strict control over staff (down 26%), and overheads (down 32%, after adjusting for forex gains included under this item). As a result, the company ended the year with margins at 7.8% (down 240bps). We believe margins will hold up as commodity prices remain soft.

## We raise forecasts to reflect the surprise

We raise margin expectations by 180bps to 8.1% for FY10 and 110bps to 8.5% in FY11, and thereby EBITDA forecasts by 33% and 17% in FY10 & FY11 resp. We retain truck volume assumptions of 5% decline in FY10, and 10% growth in FY11.

## Business outlook muted

Our CV outlook is muted, on slowing economy and infrastructure related investments. We however are positive on buses (~39% of volumes), as well as light vehicles (Nissan JV operational only in CY11). By FY11, we expect new entrants in CVs. We therefore expect company to lose share in CVs.

## Reiterate Underperform with higher PO

Our revised PO of Rs13.4 (earlier Rs11.2), is based on 5x FY10E EV/EBITDA, in line with mid-cycle valuations.

## Estimates (Mar)

(Rs)	2008A	2009A	2010E	2011E	2012
Net Income (Adjusted - mn)	4,785	2,023	1,769	1,770	NA
EPS	3.60	1.48	1.30	1.30	NA
EPS Change (YoY)	6.1%	-58.8%	-12.5%	0%	NA
Dividend / Share	1.50	1.00	1.00	1.00	NA
Free Cash Flow / Share	2.93	(3.30)	(0.817)	(3.56)	NA

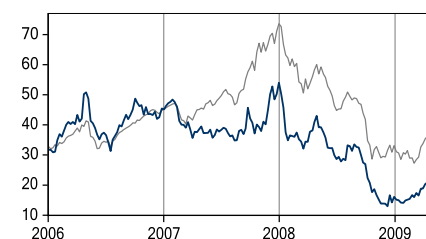
## Valuation (Mar)

	2008A	2009A	2010E	2011E	2012
P/E	6.10x	14.82x	16.94x	16.93x	NA
Dividend Yield	6.83%	4.56%	4.56%	4.56%	NA
EV / EBITDA*	4.27x	7.21x	6.76x	5.64x	NA
Free Cash Flow Yield*	13.01%	-15.03%	-3.72%	-16.22%	NA

\* For full definitions of *iQmethod*<sup>SM</sup> measures, see page 5.

## Stock Data

Price	Rs21.95
Price Objective	Rs11.2 to Rs13.40
Date Established	18-May-2009
Investment Opinion	C-3-7
Volatility Risk	HIGH
52-Week Range	Rs12.30-Rs40.30
Mrkt Val / Shares Out (mn)	US\$607 / 1,365.1
Average Daily Volume	4,472,738
ML Symbol / Exchange	XDBVF / BSE
Bloomberg / Reuters	AL IN / ASOK.BO
ROE (2010E)	8.1%
Net Dbt to Eqty (Mar-2009A)	57.5%
Est. 5-Yr EPS / DPS Growth	5.0% / 5.0%
Free Float	50.4%



– Ashok Leyland – Bombay S.E. National Index

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## iQprofile<sup>SM</sup> Ashok Leyland

Key Income Statement Data (Mar)	2008A	2009A	2010E	2011E	2012
<b>(Rs Millions)</b>					
Sales	77,291	59,810	62,021	70,311	NA
Gross Profit	13,476	9,626	11,432	13,206	NA
Sell General & Admin Expense	(5,243)	(4,582)	(6,029)	(6,809)	NA
Operating Profit	6,154	2,910	3,106	3,671	NA
Net Interest & Other Income	355	(691)	(962)	(1,525)	NA
Associates	0	0	0	0	NA
Pretax Income	6,509	2,219	2,145	2,145	NA
Tax (expense) / Benefit	(1,724)	(196)	(375)	(375)	NA
Net Income (Adjusted)	4,785	2,023	1,769	1,770	NA
Average Fully Diluted Shares Outstanding	1,330	1,365	1,365	1,365	NA

### Key Cash Flow Statement Data

Net Income	4,785	2,023	1,769	1,770	NA
Depreciation & Amortization	1,774	1,784	1,896	2,326	NA
Change in Working Capital	3,550	230	119	(105)	NA
Deferred Taxation Charge	0	0	0	0	NA
Other Adjustments, Net	(70)	(27)	(50)	0	NA
Cash Flow from Operations	10,038	4,010	3,735	3,990	NA
Capital Expenditure	(6,140)	(8,515)	(4,850)	(8,850)	NA
(Acquisition) / Disposal of Investments	(3,888)	(2,500)	(2,500)	(5,000)	NA
Other Cash Inflow / (Outflow)	0	0	0	0	NA
Cash Flow from Investing	(10,028)	(11,015)	(7,350)	(13,850)	NA
Shares Issue / (Repurchase)	194	35	0	0	NA
Cost of Dividends Paid	(2,337)	(1,597)	(1,597)	(1,597)	NA
Cash Flow from Financing	155	7,452	3,503	5,403	NA
Free Cash Flow	3,898	(4,505)	(1,115)	(4,860)	NA
Net Debt	4,361	12,472	17,884	29,541	NA
Change in Net Debt	2,307	8,111	5,412	11,657	NA

### Key Balance Sheet Data

Property, Plant & Equipment	15,256	21,822	25,776	33,300	NA
Other Non-Current Assets	11,391	13,599	15,099	19,099	NA
Trade Receivables	3,758	2,622	2,719	3,467	NA
Cash & Equivalents	4,514	4,961	4,848	391	NA
Other Current Assets	20,481	16,625	16,350	17,467	NA
Total Assets	55,400	59,629	64,791	73,725	NA
Long-Term Debt	1,902	8,500	13,800	21,500	NA
Other Non-Current Liabilities	2,538	2,538	2,338	2,138	NA
Short-Term Debt	6,973	8,932	8,932	8,432	NA
Other Current Liabilities	22,719	17,958	17,899	19,659	NA
Total Liabilities	34,133	37,929	42,969	51,730	NA
Total Equity	21,267	21,700	21,822	21,995	NA
Total Equity & Liabilities	55,400	59,629	64,791	73,725	NA

### iQmethod<sup>SM</sup> - Bus Performance\*

Return On Capital Employed	16.0%	7.0%	6.1%	6.1%	NA
Return On Equity	23.9%	9.4%	8.1%	8.1%	NA
Operating Margin	8.0%	4.9%	5.0%	5.2%	NA
EBITDA Margin	10.3%	7.8%	8.1%	8.5%	NA

### iQmethod<sup>SM</sup> - Quality of Earnings\*

Cash Realization Ratio	2.1x	2.0x	2.1x	2.3x	NA
Asset Replacement Ratio	3.5x	4.8x	2.6x	3.8x	NA
Tax Rate (Reported)	26.5%	8.9%	17.5%	17.5%	NA
Net Debt-to-Equity Ratio	20.5%	57.5%	82.0%	134.3%	NA
Interest Cover	7.4x	2.5x	1.9x	1.7x	NA

### Key Metrics

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

### Company Description

Ashok Leyland (established 1948) is one of the leading commercial vehicle (CV) manufacturers in India. Part of the Hinduja group, the company operates out of six manufacturing plants located in South India. The company's product range comprises of heavy/medium trucks and buses, encompassing about 65% of the Indian CV market.

### Investment Thesis

We expect Ashok Leyland to underperform. The company expects a recovery in the commercial vehicle segment, but we expect higher interest rates to delay this further to fiscal 2010. We believe that intensifying competition in the sector, from both the dominant player Tata Motors and newer entrants, will hit the company's business prospects. Also, given the substantial capex outlay, we believe higher fixed costs will weigh down medium-term growth and execution risks will affect valuations.

### Stock Data

Price to Book Value	1.4x
Book Value Date Last Qtr	1-Mar-2009

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Table 1: Quarterly earnings summary

(Rs mn)	4QFY09	4QFY08	3QFY09	YoY	QoQ	4QFY09E	var
Net Sales	12,181	25,620	10,008	-52.5%	21.7%	11,691	4.2%
Other Income	131	19	256	603.8%	-48.8%	210	-37.6%
Of which forex gain/loss	60	0	150				
<b>Total Income</b>	<b>12,312</b>	<b>25,639</b>	<b>10,264</b>	<b>-52.0%</b>	<b>20.0%</b>	<b>11,901</b>	<b>3.5%</b>
increase/ (decrease) in stock	2,602	1,789	1,279	45.4%	103.4%		
Consumption of raw material	5,780	16,667	5,675	-65.3%	1.8%	8,210	2.1%
Staff Cost	1,240	1,674	1,225	-25.9%	1.2%	1,380	-10.1%
Other Expenditure	1,652	2,436	1,631	-32.2%	1.3%	1,453	13.7%
Expenditure	11,273	22,565	9,810	-50.0%	14.9%	11,043	2.1%
<b>Operating Profit</b>	<b>908</b>	<b>3,055</b>	<b>199</b>	<b>-70.3%</b>	<b>357.4%</b>	<b>648</b>	<b>40.1%</b>
Interest income (exp)	-440	-91	-394	383.4%	11.7%	-309	42.6%
Depreciation (Provision)	-480	-486	-358	-1.3%	34.1%	-341	40.8%
<b>Profit before Tax &amp; Extra Ord.</b>	<b>119</b>	<b>2,496</b>	<b>-297</b>	<b>-95.2%</b>	<b>140.0%</b>	<b>209</b>	<b>-43.0%</b>
Extraordinary Items (Exp)	205	-22	461	1039.5%	-55.6%	-483	
Profit before Tax	324	2,474	163	-86.9%	98.5%	-274	-218.1%
Tax (Provision)	210	-669	26	131.3%	717.6%	-14	-1631.1%
Profit after Tax	533	1,806	189	-70.5%	182.6%	-288	-285.3%
<b>Net Profit</b>	<b>269</b>	<b>1,822</b>	<b>-422</b>	<b>-85.3%</b>	<b>163.7%</b>	<b>476</b>	<b>-43.6%</b>
		0.0	0.0				
<b>OPM</b>	<b>7.5%</b>	<b>11.9%</b>	<b>2.0%</b>	<b>-447bps</b>	<b>547bps</b>	<b>5.5%</b>	<b>191bps</b>
RM/Sales	68.8%	72.0%	69.5%	-323bps	-67bps	70.2%	-142bps
Staff Cost/Sales	10.2%	6.5%	12.2%	365bps	-206bps	11.8%	-162bps
Other Expenses/Sales	13.6%	9.5%	16.3%	405bps	-273bps	12.4%	113bps
Tax	-64.7%	27.0%	-15.7%	-9175bps	-4902bps	-5.0%	-5974bps
Sales Volume (nos)	10,863	27,311	8,011	-60.2%	35.6%	10,219	6.3%
Avg Realisation (Rs)	1,121,350	938,085	1,249,343	19.5%	-10.2%	1,144,086	-2.0%

Source: Company, Banc of America Securities-Merrill Lynch Research

Table 2: Revision in estimates

Rs mn, '000s volume	Earlier		Revised		Revision	
	FY10E	FY11E	FY10E	FY11E	FY10E	FY11E
Domestic volumes (nos)						
- Trucks	30	32	30	32	0.0%	0.0%
- Total domestic	45	50	47	52	3.2%	3.2%
Total volumes (nos)	52	57	54	59	4.6%	4.7%
Sales	60	69	62	70	3.4%	2.1%
EBITDA	3.8	5.1	5.0	6.0	33.1%	17.3%
Margin	6.3%	7.4%	8.1%	8.5%	180bps	111bps
PAT	1.0	1.0	1.8	1.8	79.5%	80.8%
EPS	0.72	0.72	1.30	1.30	79.5%	80.8%

Source: Banc of America Securities-Merrill Lynch Research

## Price objective basis & risk

### Ashok Leyland (XDBVF)

Our PO of Rs 13.4 is based on 5x FY10E EV/EBITDA, in line with mid-cycle valuations. Risks: Slower recovery in trucks on economic slowdown, project execution concerns and competition. Upside risks: quicker than expected moderation of commodity prices and faster than expected economic recovery.

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### India - Autos Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	Hero Honda	HRHDF	HH IN	S.Arun
	Maruti Suzuki India	MUDGF	MSIL IN	S.Arun
	TVS Motor	XFKMF	TVSL IN	S.Arun
<b>NEUTRAL</b>				
	Bajaj Auto	XBJBF	BJAUT IN	S.Arun
	Bajaj Hldgs & Inv-G	BJAUF	BAUD LI	S.Arun
	Bajaj Holdings and Investment	BJJAF	BJHI IN	S.Arun
	Eicher Motors	XEICF	EIM IN	S.Arun
	Jet Airways	JTAIF	JETIN IN	S.Arun

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India - Autos Coverage Cluster

Investment rating	Company	ML ticker	Bloomberg symbol	Analyst
<b>UNDERPERFORM</b>				
	Ashok Leyland	XDBVF	AL IN	S.Arun
	Bharat Forge	XUUVF	BHFC IN	S.Arun
	Container Corp	CIDFF	CCRI IN	Sanjaya Satapathy
	Gateway Distriparks	GYDPF	GDPL IN	S.Arun
	M & M	MAHMF	MM IN	S.Arun
	M & M -G	MAHMF	MHID LI	S.Arun
	Tata Motors Ltd.	TENJF	TTMT IN	S.Arun
	Tata Motors Ltd.	TTM	TTM US	S.Arun

*iQmethod*<sup>SM</sup> Measures Definitions

Business Performance	Numerator	Denominator
Return On Capital Employed	NOPAT = (EBIT + Interest Income) * (1 - Tax Rate) + Goodwill Amortization	Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization
Return On Equity	Net Income	Shareholders' Equity
Operating Margin	Operating Profit	Sales
Earnings Growth	Expected 5-Year CAGR From Latest Actual	N/A
Free Cash Flow	Cash Flow From Operations – Total Capex	N/A
<b>Quality of Earnings</b>		
Cash Realization Ratio	Cash Flow From Operations	Net Income
Asset Replacement Ratio	Capex	Depreciation
Tax Rate	Tax Charge	Pre-Tax Income
Net Debt-To-Equity Ratio	Net Debt = Total Debt, Less Cash & Equivalents	Total Equity
Interest Cover	EBIT	Interest Expense
<b>Valuation Toolkit</b>		
Price / Earnings Ratio	Current Share Price	Diluted Earnings Per Share (Basis As Specified)
Price / Book Value	Current Share Price	Shareholders' Equity / Current Basic Shares
Dividend Yield	Annualised Declared Cash Dividend	Current Share Price
Free Cash Flow Yield	Cash Flow From Operations – Total Capex	Market Cap. = Current Share Price * Current Basic Shares
Enterprise Value / Sales	EV = Current Share Price * Current Shares + Minority Equity + Net Debt + Other LT Liabilities	Sales
EV / EBITDA	Enterprise Value	Basic EBIT + Depreciation + Amortization

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### XDBVF Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	27	36.49%	Buy	7	29.17%
Neutral	16	21.62%	Neutral	6	50.00%
Sell	31	41.89%	Sell	14	56.00%

### Investment Rating Distribution: Global Group (as of 01 Apr 2009)

Coverage Universe	Count	Percent	Inv. Banking Relationships*	Count	Percent
Buy	1243	38.21%	Buy	520	46.39%
Neutral	841	25.85%	Neutral	349	47.04%
Sell	1169	35.94%	Sell	388	36.30%

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Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

\* Ratings dispersions may vary from time to time where BAS-ML Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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