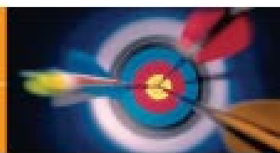
investor's eye



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Take Five

Scrip	Reco Date	Reco Price	CMP	Target
Balaji Tele	9-July-07	231	**255**	303
HUL	24-Nov-05	172	**202**	280
ICICI Bank	23-Dec-03	284	**872**	1,173
JP Associates	30-Dec-03	125	**897**	1,061
Madras Cement	17-Nov-05	1,498	**3,550**	3,700

Ashok Leyland

Ugly Duckling

Stock Update

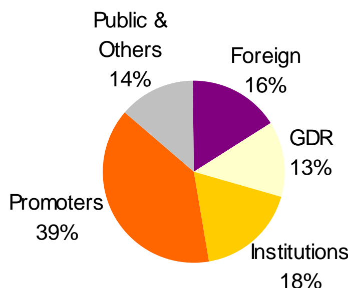
In tie up with Nissan

Hold; CMP: Rs38

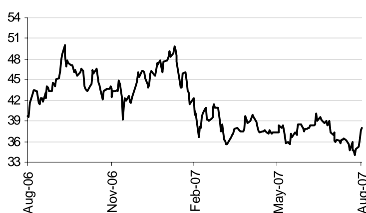
Company details

Price target:	Rs42
Market cap:	Rs4,998 cr
52 week high/low:	Rs51.2/33.9
NSE volume: (No of shares)	31.5 lakhs
BSE code:	500477
NSE code:	ASHOKLEY
Sharekhan code:	ASHOKLEY
Free float: (No of shares)	63.2 cr

Shareholding pattern



Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	1.1	0.9	-1.8	-2.2
Relative to Sensex	2.6	-2.9	-16.0	-24.6

Key points

- Ashok Leyland and Nissan Motor Company, Japan have agreed to form three joint venture companies in India to develop, manufacture and market light commercial vehicle (LCV) products.
- Both companies are also examining ways to tap each other's dealer networks in India and elsewhere. A final agreement would be signed after the feasibility study concludes by October 2007.
- The tie up should aid Ashok Leyland to expand its product offerings and introduce products in the sub-6 tonne category, where it currently lacks presence. However, the setting up of the plant would take at least 18-24 months and hence the first roll out of the new products is expected only in FY2010.
- The commercial vehicle segment is currently witnessing a slowdown, which is impacting Ashok Leyland as well. We continue to watch keenly the commercial vehicle segment in India to determine any signs of revival. We expect things to improve in the second half of the fiscal with the advent of the festive season.
- For FY2008 we expect the company to report a sales volume growth of 3.2%.
- At current levels, the stock discounts its FY2009E earnings by 9.7x and is available at an enterprise value (EV)/earnings before interest, depreciation, tax and amortisation (EBIDTA) of 6.2x. We maintain our Hold on the stock.

Forming joint venture with Nissan Motor

Ashok Leyland and Nissan Motor Company, Japan have singed a heads of agreement to form three joint venture companies in India mainly to penetrate the Indian LCV market.

- **Vehicle manufacturing company -** This company will have exclusive rights to manufacture LCV products in India for both the partners. The manufacturing facilities will be located in India and will be majority owned by Ashok Leyland. In the medium term, production volume (for Indian and export markets) is expected to be above 100,000 units annually.

Earnings table

Particulars	FY2005	FY2006	FY2007	FY2008E	FY2009E
Net sales (Rs cr)	4,247.7	5,329.8	7,320.4	7,920.6	9,144.6
Net profit (Rs cr)	271.4	327.0	441.3	401.0	517.2
% y-o-y growth		*20.0*	*35.0*	*-9.0*	*29.0*
EPS (Rs)	1.8	2.2	3.1	3.0	3.9
% y-o-y growth		*20.0*	*35.0*	*-9.0*	*29.0*
PER (x)	21.4	17.5	12.3	12.4	9.7
P/BV (Rs)	4.3	3.5	2.6	2.4	2.1
EV/EBIDTA (x)	11.7	8.9	7.4	7.8	6.2
RoCE (%)	19.3	21.7	25.8	21.9	24.6
RoNW (%)	20.0	20.2	21.5	19.4	21.9

- **Power train manufacturing company -** This company will be responsible for the manufacture and assembly of engines and other components to be fitted in the LCV products and for exports. The manufacturing facility will be located in India and the Company will be majority owned by Nissan Motor Company.

- **Technology development company -** This company will develop LCV products and related power trains destined for the Indian and identified emerging markets. This JV Company will be owned 50:50 by the two partners. The products developed will be sold under both the Company and Nissan brands.

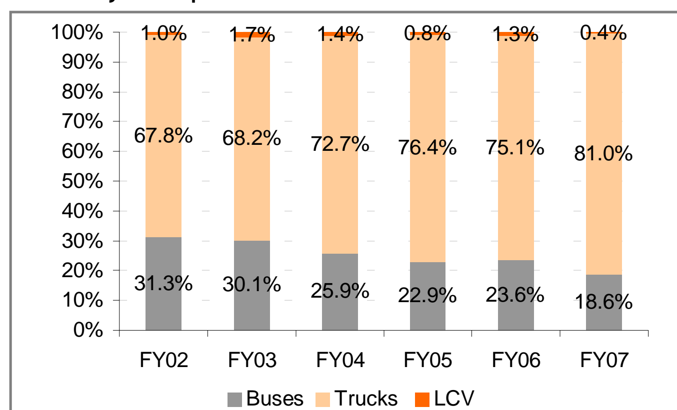
Final agreement to be signed post feasibility study

Both the companies are evaluating the tie up and will be conducting a feasibility study to increase co-operation in sales and distribution. This would include providing Nissan Motor with access to Ashok Leyland's dealer network in India and allowing Ashok Leyland to use Nissan Motor's dealer networks in the identified export markets outside India. Post feasibility studies, a final agreement shall be signed by October 2007.

Impact analysis

This tie up should be a positive development for Ashok Leyland, as it would help it to expand its product portfolio and in all likelihood would help it to launch products in the sub-6 tonne category, where it currently does not have presence. The following table shows the product mix of Ashok Leyland over the last few years. Currently, LCVs accounts for less than 1% of the total sales volumes. This venture should facilitate the company to expand its range going forward and get a piece of this high growth segment. However, the setting up of the plant would take at least 18-24 months and hence the first roll out of new products is expected only in FY2010.

Ashok Leyland's product mix



Worldwide, Nissan Motor has strong products like Atlas range (in sub-2 tonne category), Vanette truck, Clipper truck and a number of other products in the 2 tonne to 12 tonne capacity, which can be introduced in India considering a strong demand and growth opportunities in the LCV segment. The amount of investment, the product range etc are still to be worked out and shall be announced by the company at a later date. We believe that setting up of the LCV plant along with the power train facility would entail an investment of at least Rs1000 crore.

Valuations

The commercial vehicle industry, in the recent past, has been hit by a sharp slowdown due to lesser finance availability, higher interest rates, higher base of last year and seasonal factors. Already there are heavy discounts being offered in the heavy trucks segment, whereas the slowdown had led to significant inventory build up. The situation is expected to improve once the festive season begins. The interest rates have come down by almost 200 basis points on an average to about 10% currently, while the financiers have also softened their earlier stance. All these factors combined are expected to revive the sales volumes in the second half of the fiscal. We continue to track the segment actively and will keep you updated.

We estimate Ashok Leyland to report a sales volume growth of 3.2% for FY2008. At the current market price of Rs38, the stock discounts its FY2009E earnings by 9.7x and is available at an EV/EBIDTA of 6.2x. We maintain our Hold on the stock.

The author doesn't hold any investment in any of the companies mentioned in the article.

Telecommunications

Sector Update

TRAI recommendations on licensing policy and spectrum

Policy changes positive for Reliance Communications, negative for Bharti Airtel and Idea Cellular

The Telecom Regulatory Authority of India (TRAI) has recommended certain measures in the licensing policy ranging from issues like the entry limit and spectrum allocation, merger & acquisition (M&A) guidelines, usage of technologies and rollout obligations. The recent policy initiatives are favourable for Reliance Communication as it sets the framework for its proposed rollout of services under the GSM technology. On the other hand, the large GSM operators would be adversely impacted due to the enhanced subscriber criteria for additional spectrum (as it would result in higher capital expenditure [capex] requirement) and increased cost of services (due to the increase in the annual usage charges and the levy of one-time charge on additional spectrum). However, it should be noted that these are only recommendations and have not been notified by the concerned government department yet. We expect the GSM operators to strongly oppose some of the recommendations.

The key recommendations and its implications are given below.

 # Spectrum allocation and entry of new operators

- There will be no cap on the number of access service providers in any service area.
- In order to frame a new spectrum allocation criteria, a multidisciplinary committee may be formed. But as an interim measure the present subscriber norms have been enhanced significantly. The other measures related to spectrum charges are:

1. The annual usage charges have been increased by 1% (as percentage of sales) beyond 8Mhz.

Enhanced subscriber criteria for additional spectrum
GSM subscriber base criteria (millions of subscribers)

Service area	2 x 6.2 MHz	2 x 8 MHz	2 x 10 MHz	2 x 12.4 MHz	2 x 15 MHz
Delhi/Mumbai	0.5	1.5	2	3	5
Chennai/Kolkatta	0.5	1.5	2	3	5
A	0.8	3	5	8	10
B	0.8	3	5	8	10
C	0.6	2	4	6	8

CDMA subscriber base criteria (millions of subscribers)

Service area	3rd carrier 2 x 3.75 MHz	4th carrier 2 x 5 MHz	5th carrier 2 x 6.25 MHz	6th carrier 2 x 7.5 MHz
Delhi/Mumbai	0.5	2	3	5
Chennai/Kolkatta	0.5	2	3	5
A	0.8	5	8	10
B	0.8	5	8	10
C	0.6	4	6	8

Increase in annual spectrum usage charges

Spectrum	Current	Proposed
Upto 2 x 4.4MHz	2.0%	No change
Upto 2 x 6.2MHz/2 x 5MHz	3.0%	No change
Upto 2 x 8MHz	4.0%	No change
Upto 2 x 10MHz	4.0%	5.0%
Upto 2 x 12.5MHz	5.0%	6.0%
Upto 2 x 15MHz	6.0%	7.0%
Beyond 2 x 15MHz		8.0%

2. The regulator has recommended levying a one-time charge if any licensee wishes to get additional spectrum beyond 10 MHz in the existing 2G bands i.e. 800,900 and 1800 MHz. The one-time charge for each additional 1 MHz would be Rs16 crore for category A, Rs8 crore for category B and Rs3 crore for category C circles.

Additional one-time charge (for every 2 x 5MHz)

Service areas	Price (Rs crore)
Mumbai,Delhi and category A	80
Chennai, Kolkatta and category B	40
Category C	15

Implication

The removal of the cap on the number of service providers is negative for the existing players. However, the constraint on spectrum availability is likely to resstrict the entry of new operators.

The spectrum allocation criteria is negative for GSM players (especially the large players) because the enhanced criteria for additional spectrum would limit the release of spectrum to the existing players. To manage the existing spectrum, operators would have to boost capex requirements to support the growing subscriber base. Moreover, the levy of one-time charge and the increase in the annual usage

charges beyond 10 MHz would also add to the service cost of the mobile operators.

M&A guidelines

The existing cap on the combined spectrum has been removed and the cross-holding limit has been enhanced to 20% (up from 10%). But the cap on the market share of the merged entity has been reduced to 40% (down from 67% earlier) based on either subscriber base or the adjusted gross revenues. Moreover, the merger activity would not be allowed if the number of service provider in the area is reduced below four post merger.

Implication

The revised recommendations indicate that the regulator is too cautious about any form of monopoly being created through consolidation in the industry. However, the consolidation among the smaller players would become more attractive now.

Use of alternate or combination of technologies

- In case a new licensee wishes to deploy any other advanced and efficient technology for providing mobile service, the department of telecommunications should allocate spectrum subject to its availability.
- An existing licensee may be permitted to use alternate technology to provide wireless access service subject to following conditions:

1. On payment of an upfront fee which should be at least equal to the entry fee for universal access services licence in that service area.
2. Such a licensee shall maintain separate details of the subscriber base data for the purposes of spectrum allocation. For the spectrum charges, the spectrum under two technologies would be merged to determine the prescribed rate.

Implication

The recommendations set the regulatory framework for the operators looking at providing services using combination of technologies (both CDMA and GSM) such as Reliance Communications.

It also means that the existing players would have to pay additional licensee fee for the introduction of 2.5G or 3G services (in addition to auction charges for the spectrum). Thus, it is negative for all existing players.

Rollout obligations

- As per this framework a licensee who covers 75% of development blocks in any service area (excluding the four Metro service areas) would be eligible for a payment of Universal Service Obligation fee (USO) at a reduced scale. Such a licensee will be required to pay the USO of only 3% as against the existing level of 5%.

Implication

Telecom operators with impressive rollout track record like Bharti Airtel and Reliance Communication could benefit from lower USO obligations. The lower USO could also negate some of the adverse impact from the changes related to spectrum charges.

Company analysis

Bharti Airtel	Overall impact: Negative
Positives • Possibility of lower USO obligation in some circles.	*Negatives* • Higher service cost due to one-time charge and higher annual usage charges for spectrum. This could roughly be in the range of Rs100-120 crore. • Enhanced spectrum criteria to limit release of additional spectrum. Bharti Airtel was eligible for additional spectrum in 14 circles, which is reduced to four now.
Reliance Communication	**Overall impact: Positive**
Positives • Would be able to rollout GSM services in additional circles due to clarity on the regulatory framework for use of combined technology. However, it would have to incur additional cost of around Rs1500 crore for the allocation of spectrum. • Enhanced subscriber criteria for GSM operators provide scope for availability of spectrum for its GSM services once defence forces release some of it for commercial use. • Possibility of lower USO obligation in some circles.	*Negatives* • Higher service cost due to one-time charge and higher annual usage charges for spectrum. • Separate rollout obligation for services under alternate technologies means that the company cannot offer GSM services only in the lucrative part of the telecom circle. • Additional spectrum for GSM services would attract one-time charge. For the required circles (around 15) it works out to around Rs1500 crore.
Idea Cellular	**Overall impact: Negative**
Positives • Possibility of lower USO obligation in some circles.	*Negatives* • Higher service cost due to one-time charge and higher annual usage charges for spectrum. • Enhanced spectrum criteria to limit release of additional spectrum in some of its circles. • M&A activity could become more difficult and expensive.

Cement

Sector Update

Two companies from Pakistan get BIS approval

Two cement companies from Pakistan namely Pakistan Lucky Cement and Maple Leaf Cement have received the Bureau of Indian Standards (BIS) approval for exporting cement to India. Six other firms from Pakistan are awaiting final approval from the BIS. The approval allows these companies to directly export cement to private players in India. But we understand that the logistical bottlenecks at the ports as well as constraints in exporting cement through road will limit the total cement imports from Pakistan to about 2 million metric tonne (MMT). We also learn that the local cement prices in northern Pakistan (a potential region of exports) have gone up by Rs20 per bag to Rs215 per bag. Though we agree that the cement imports via the ports should impact the players in the western region namely Ambuja Cements, Sanghi Cement et al, but by and large the impact on the industry would not be significant. We maintain our positive outlook on the sector with Grasim and Jaiprakash as our top picks.

Government authorised MMTC to import cement

The Ministry of Commerce & Industry had directed Minerals and Metals Trading Corporation (MMTC) to import cement from the foreign manufacturers who have not received the BIS certification. The exemption to import without the BIS mark will be valid for 150 days from the date of recording of application or till the grant of regular license by the BIS to the foreign manufacturer. Once the companies receive the BIS certification, anybody can import cement. But as two players from Pakistan have already received the BIS certification and six other players are in the final stages of receiving the approval, they would not have to go through the MMTC route to export cement to India.

Key takeaways from our conversation with Lucky Cement

- Lucky Cement of Pakistan has already received the BIS approval for exporting cement to India. The other manufacturer from Pakistan to secure the approval is Maple Leaf, a part of the Kohinoor Maple Leaf group.

- Lucky Cement has entered into a contract with private construction players in India to export close to 100,000 metric tonne of cement, which will come in small consignments of 8,000-10,000 tonne over a period of time. The cement will be exported through the sea route to India in 50kg polypropylene laminated bags.

- We learn that the current free on board (FOB) price of cement at Karachi is $66-70 per tonne. Adding the freight cost of $25 per tonne, the FOB price at Mumbai should be in the range of $91-95 per tonne.

- Currently it is not possible to import cement through the Wagah border on account of a 5 km of no man's land where the cement bags would have to be manually loaded and unloaded. But the Indian and Pakistani governments are negotiating to ease the road transport through the border and a positive development on that front is expected by October this year.

- Six manufacturers out of the total ten who have applied to the BIS are expected to receive approval in the next couple of months.

- We also learn that the domestic prices in northern Pakistan have gone up by Rs20 per bag to Rs215 per bag.

End use price could be higher than expected

We believe that the end user price of imported cement to a retail customer would be in the range of Rs235-240 per bag (including value added tax [VAT] charge of 12.5% +domestic freight) whereas it would lower for the trade segment as they would not have to pay VAT.

Particulars	Amount
FOB at Karachi port (US$/tonne)	66.0
Freight and Insurance (US$/tonne)	25.0
CIF at Mumbai Port / JNPT (US$/tonne)	91.0
Re/$	40.7
CIF at Mumbai Port / JNPT (Rs/tonne)	3640.0
C&F charges (Rs/tonne)	500.0
Landed cost (Rs/tonne)	4140.0
Landed cost (Rs/bag)	207.0

Could be higher going ahead

The end user prices in Gujarat are currently hovering at Rs220-225 per bag whereas prices in Mumbai are much higher at Rs260-270 per bag. The imports from Pakistan may depress the pricing power of players in the western region namely Gujarat Ambuja, Ultratech, Sanghi Industries, ACC et al as the cost of the imported cement will be much less than the domestic prices ruling currently in the region. But with the prices rising in the domestic

market of Pakistan, we believe that our price assumption of $66 per tonne at Karachi could be conservative and thus the end user prices in India could be much higher than expected, narrowing the difference with the local prices.

Our outlook

With the total imports from Pakistan estimated at 2MMT, we do believe that the cement manufacturers in the states of Maharastra and Gujarat in the western part of India will be impacted. But again the actual quantum of the imports depends upon the local prices in Pakistan as well as the developments on the road transport front keeping in mind the logistical bottlenecks at the ports.

The imports through the sea route will depress the pricing power of players in the western region namely Gujarat Ambuja, Ultratech, Sanghi Industries, ACC et al as the cost of imported cement will be much less than the domestic prices. Though the cement players in the South would not be directly affected (as the additional cost of inland transportation will narrow down the price differential), the inter-regional transport from Andhra Pradesh (AP) to the western region will come down, in effect creating a surplus situation in AP, which will consequently depress the prices in the southern region as well. The impact on the prices in the North is again contingent upon the developments on the road transport front. But considering the fact that the potential cement imports of 2MMT is hardly 4 % of the total cement consumption of the West and the North, we believe that the impact of the imports on the industry prices will be muted.

Maintain our estimates

We maintain our estimates currently, as we believe that our price assumptions are conservative. We maintain our buy on Grasim and Jaiprakash Associates. We also like India Cements and Orient Paper.

The author doesn't hold any investment in any of the companies mentioned in the article.

Sharekhan Stock Ideas

Evergreen

HDFC Bank
Infosys Technologies
Reliance Industries
Tata Consultancy Services

Apple Green

Aditya Birla Nuvo
ACC
Apollo Tyres
Bajaj Auto
Bank of Baroda
Bank of India
Bharat Bijlee
Bharat Electronics
Bharat Heavy Electricals
Bharti Airtel
Canara Bank
Corporation Bank
Crompton Greaves
Elder Pharmaceuticals
Grasim Industries
HCL Technologies
Hindustan Unilever
ICICI Bank
Indian Hotels Company
ITC
Mahindra & Mahindra
Marico
Maruti Suzuki India
Lupin
Nicholas Piramal India
Ranbaxy Laboratories
Satyam Computer Services
SKF India
State Bank of India
Sundaram Clayton
Tata Motors
Tata Tea
Unichem Laboratories
Wipro

Cannonball

Allahabad Bank
Andhra Bank
Gateway Distriparks
International Combustion (India)
JK Cement
Madras Cement
Shree Cement
Tourism Finance Corporation of India
Transport Corporation of India

Emerging Star

3i Infotech
Aban Offshore
Alphageo India
Axis Bank (UTI Bank)
Balaji Telefilms
Cadila Healthcare
Federal-Mogul Goetze (India)
KSB Pumps
Marksans Pharma
Navneet Publications (India)
Network 18 Fincap
Nucleus Software Exports
Orchid Chemicals & Pharmaceuticals
ORG Informatics
Tata Elxsi
Television Eighteen India
Thermax

Ugly Duckling

Ahmednagar Forgings
Ashok Leyland
Aurobindo Pharma
BASF India
Ceat
Deepak Fertilisers & Petrochemicals Corporation
Genus Power Infrastructures
Hexaware Technologies
ICI India
India Cements
Indo Tech Transformers
Jaiprakash Associates
KEI Industries
NIIT Technologies
Punjab National Bank
Ratnamani Metals and Tubes
Sanghvi Movers
Saregama India
Selan Exploration Technology
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Subros
Sun Pharmaceutical Industries
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