



## INDIA

AL IN Neutral

Price 30 Apr 10 Rs60.30

12-month target Rs 62.00

Upside/Downside % 2.8

Valuation Rs 62.00

- EV/EBITDA

GICS sector Capital Goods

Market cap Rsm 80,199

30-day avg turnover US\$m 4.3

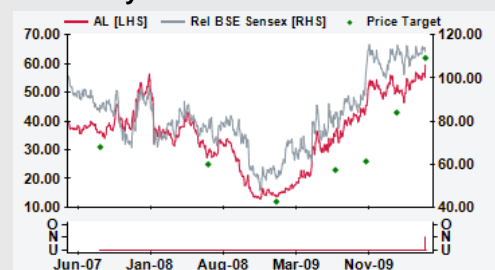
Market cap US\$m 1,648

Number shares on issue m 1,330

### Investment fundamentals

Year end 31 Mar		2010A	2011E	2012E	2013E
Total revenue	bn	72.4	89.2	104.6	118.1
EBITDA	bn	7.6	10.0	11.8	13.3
EBITDA growth	%	61.4	31.3	17.9	12.4
EBIT	bn	5.6	7.6	9.1	10.5
EBIT growth	%	89.9	35.2	20.9	14.2
Reported profit	bn	4.2	5.5	6.6	7.5
Adjusted profit	bn	4.3	5.5	6.6	7.5
EPS rep	Rs	3.18	4.16	4.96	5.64
EPS rep growth	%	123.2	30.7	19.1	13.8
EPS adj	Rs	3.20	4.16	4.96	5.64
EPS adj growth	%	110.9	29.9	19.1	13.8
PER rep	x	18.9	14.5	12.2	10.7
PER adj	x	18.8	14.5	12.2	10.7
Total DPS	Rs	1.50	1.60	1.80	2.20
Total div yield	%	2.5	2.7	3.0	3.6
ROA	%	7.0	8.8	9.9	10.7
ROE	%	11.9	14.5	15.8	16.4
EV/EBITDA	x	13.1	10.0	8.5	7.6
Net debt/equity	%	54.9	66.8	68.3	63.3
P/BV	x	2.2	2.0	1.8	1.7

### AL IN rel BSE Sensex performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, April 2010

(all figures in INR unless noted)

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3 May 2010

# Ashok Leyland

## Good 4Q results; stock looks fairly valued

### Event

- Ashok Leyland reported a good set of 4Q FY3/10 numbers. We are increasing our earnings estimates to factor in stronger-than-expected volume growth and savings from a new plant at Uttarakhand. After a 10% jump in the share price post results and ~21% return so far in the calendar, we see limited upside potential and hence upgrade the stock to Neutral from Underperform.

### Impact

- Good 4Q results:** Ashok Leyland reported net sales of Rs29.4bn, up 141% YoY, in line with estimates. Operating profit came in at Rs3.78bn (up 230% YoY), as margins expanded 150bp on a QoQ basis. PAT at Rs2.2bn for the quarter was ~10% ahead of estimates.
- Expect robust volume growth backed by recovery in South market:** Overall commercial vehicles (CV) sales in the current fiscal year should benefit from a recovery in industrial activities and a pickup in the investment cycle. With improvement in demand in the key South India market (Ashok Leyland has more than a 50% market share) and in the multi-axles and tractor trailer segments, we expect Ashok Leyland's M&HCV sales to grow by 23% and 15% in FY11 and FY12, respectively.
- Benefits from new plant to be limited by rising raw material prices:** Ashok Leyland plans to increase production at the Uttarakhand plant to 20k units in FY11 and further to 35k units in FY12. With increased sourcing of raw materials from within the state, the company expects to save Rs40–50k per vehicle produced at the new plant. However, with rising raw material prices and limited pricing power with the entry of new players in the commercial vehicle space, we expect margin expansion to be limited to 80bp over the next couple of years.

### Earnings and target price revision

- We are increasing our earnings estimates for FY11 and FY12 by 29% and 31%, respectively. We are also increasing our target price to Rs62 from Rs43.

### Price catalyst

- 12-month price target: Rs62.00 based on a EV/EBITDA methodology.
- Catalyst: Monthly sales volumes and margin improvement

### Action and recommendation

- Upgrade to Neutral:** Ashok Leyland's share price jumped 10% post a good set of 4Q results, and the stock has provided returns of ~21% so far in the calendar year. At ~9.6x FY11E EV/EBITDA and a 14.5x FY11E PER the stock appears fairly valued, and hence we upgrade the stock to Neutral from Underperform. Stronger-than-expected growth in volumes or soft commodity prices remain key upside risks, while loss in market share and a significant jump in raw material prices from here on remain the key downside risks for the stock.

## Increase earnings on back of strong sales and savings from new plant

**Fig 1 Changes in earnings estimates**

	FY11E			FY12E		
	Old	New	% change	Old	New	% change
Net Sales (Rsm)	81,613	89,213	9.3%	92,575	104,617	13.0%
EBITDA (Rsm)	8,510	10,028	17.8%	9,745	11,823	21.3%
Net Profit (Rsm)	4,300	5,542	28.9%	5,026	6,602	31.3%
EPS (Rs)	3.2	4.2	28.9%	3.8	5.0	31.4%
EBITDA Margins (%)	10.4%	11.2%	81 bps	10.6%	11.3%	72 bps

Source: Company data, Macquarie Research, April 2010

### Key takeaways from conference call

- **Sales volume growth** – The fourth quarter of FY10 saw strong growth in the heavy-duty segment, multi-axle vehicles and tractor trailer segments, which helped Ashok Leyland improve its market share significantly, from 22% in 3Q to now 27–28% at the end of 4Q. Management expects industry volume growth to be in the range of 15–20% in FY11, with better growth in the truck segment as compared with the bus segment. The company also has an order backlog of 1,200 buses under the JnNURM scheme, which are expected to be delivered in the first quarter of the current fiscal. As demand improves in the South India market, we expect Ashok Leyland's M&HCV sales to grow by 23% in FY11 and by 15% in FY12.
- **Regionwise market share** – Ashok Leyland's market share in the South remains above 50%. Market share in the North would be ~23–25%, and in East India Ashok Leyland's market share remains weak at below 15%. With a new plant in North India, the company is increasing its focus on increasing dealership in the region and hopes to increase market share from here on.
- **Defence, spare parts and engine sales** – The company sold 2,300 defence kits in FY10 and expects sound growth in FY11 in the space. Total spare part sales increased to Rs6,430m in FY10, while engine sales declined by 9%, mainly on account of a slowdown in demand for gensets from the telecom segment.
- **Uttarakhand plant** – Ashok Leyland plans to increase production at the Uttarakhand plant to 20k units in FY11 and further to 35k units in FY12. Around 70 suppliers have also set up their units in the region, which should help increase the amount of raw materials sourced from within the state. The company expects to save Rs40–50k per vehicle produced at the new plant.
- **Raw material cost and margins** – Prices of key raw materials like steel, aluminium and tyres have been on the rise and is expected to increase further from current levels. Further raw material costs is also likely to go up on account of upgradation to BSIV/ BSIII norms. However, the company hopes that with excise benefits from increased production at the new Uttarakhand plant, cost-reduction initiatives and ~2–3% hike in prices should help to maintain margins.
- **Freight rates** have started moving up by ~8–10% in the last three months, except for the northern region. Strength in freight rates should improve profitability of fleet operators despite an increase in diesel prices and interest rates, which should be positive for overall demand.
- **Debt and cash balance** – The company's gross debt stood at Rs22bn, and cash on books was ~Rs4bn as of March 2010. Gross debt to equity remains comfortable at 0.9:1.
- **Capex and JV details** – Ashok Leyland's management has guided for standalone capex of Rs12bn spread over the next couple of years. Further, the company will invest Rs6bn in various joint ventures in the same period. The company expects its JV with Nissan for LCV to start production in early-2011. Similarly, the JV with John Deere for construction equipment will begin trial production in October 2010, and commercial operation is expected by early-2011. Ashok Leyland has also received RBI approval for its vehicle financing company, and the company will invest Rs150m as initial capital. Other group companies are also likely to have a share in the finance company, which should reduce the risk and capital required to be bought in by Ashok Leyland.

## 4Q FY3/10 result analysis

**Fig 2 Ashok Leyland – 4Q FY10 volumes**

	4Q FY09	4Q FY10	% chg	Macquarie Comments
M&HCV Passenger	4,799	6,180	28.8	Lumpy in nature, dependant on orders from State Transport Units (STU's). Company has orders of ~1200 units under the JnNURM scheme
M&HCV Goods	5,255	19,304	267.3	Benefited from recovery in overall economy and pick up in South India market
M&HCV LCV	10,054	25,484	153.5	
LCV	747	323	-56.8	
<b>Total CVs</b>	<b>10,801</b>	<b>25,807</b>	<b>138.9</b>	<b>Strong growth on low base</b>

Source: Company data, Macquarie Research, April 2010

**Fig 3 Ashok Leyland – 4Q FY10 financial data**

(Rsm)	4Q FY09	4Q FY10	% chg	Macquarie Comments
<b>Net sales</b>	<b>12,181</b>	<b>29,390</b>	<b>141.3</b>	<b>Exactly in-line with estimates</b>
Raw Materials	8838	21509	143.4	Raw material pressure to increase in coming quarters
Manpower	1,240	1,807	45.8	Marginally below estimate
Manufacturing and Other	955	2,290	139.8	Largely in-line with estimate, benefited from cost control initiatives and higher volumes
Total Expenditure	11,033	25,606	132.1	
<b>EBITDA</b>	<b>1,148</b>	<b>3,784</b>	<b>229.5</b>	<b>Margins improve on YoY and QoQ basis</b>
Interest	440	221	-49.8	Interest costs reduce as working capital requirement goes down
Other Income	131	23	-82.4	
EBDT	839	3,586	327.4	
Depreciation	480	588	22.4	Benefited from change in accounting policy, should go up with new plant in coming fiscal
PBT	359	2,998	734.9	
Exceptional	-35	-4		NA VRS expense
Tax	-210	768		NA
<b>PAT (pre exceptionals)</b>	<b>569</b>	<b>2,231</b>	<b>292.3</b>	
<b>PAT</b>	<b>533</b>	<b>2,227</b>	<b>317.6</b>	<b>Around 10% ahead of estimates</b>

Source: Company data, Macquarie Research, April 2010

**Fig 4 Ashok Leyland – 4Q FY10 key ratios**

	4Q FY09	4Q FY10	bp chg	Macquarie Comments
OPM % (Net sales)	9.4	12.9	345	Up 150bp QoQ
Tax/ PBT (%)	-58.3	25.6		NA Ramp up at new plant to benefit further
Net Profit margins (%)	4.7	7.6	292	
Raw Materials / Sales	72.6	73.2	63	Increases over 180bps on QoQ basis, to go up further in coming quarters
Staff Costs / Sales	10.2	6.1	-403	Lower than estimated due to cost control initiatives, benefits from increased volumes
Other expense / Sales	7.8	7.8	-5	Flat on QoQ basis

Source: Company data, Macquarie Research, April 2010

**Ashok Leyland (AL IN, Neutral, Target Price: Rs62.00)**

Quarterly Results						Profit & Loss					
		4Q/10A	1Q/11E	2Q/11E	3Q/11E			2010A	2011E	2012E	2013E
Revenue	m	23,980	18,735	20,162	20,787	Revenue	m	72,447	89,213	104,617	118,091
Gross Profit	m	6,556	5,057	5,443	5,611	Gross Profit	m	19,807	24,083	27,810	31,119
Cost of Goods Sold	m	17,424	13,677	14,719	15,175	Cost of Goods Sold	m	52,640	65,129	76,807	86,972
EBITDA	m	2,528	2,106	2,266	2,337	EBITDA	m	7,637	10,028	11,823	13,285
Depreciation	m	676	517	556	573	Depreciation	m	2,041	2,461	2,673	2,832
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	1,852	1,589	1,710	1,763	EBIT	m	5,596	7,567	9,150	10,453
Net Interest Income	m	-113	-142	-153	-158	Net Interest Income	m	-342	-676	-790	-822
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	-11	0	0	0	Exceptionals	m	-33	0	0	0
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	76	55	59	61	Other Pre-Tax Income	m	230	260	270	320
Pre-Tax Profit	m	1,804	1,502	1,616	1,666	Pre-Tax Profit	m	5,451	7,151	8,629	9,951
Tax Expense	m	-401	-338	-364	-375	Tax Expense	m	-1,210	-1,609	-2,028	-2,438
Net Profit	m	1,404	1,164	1,253	1,291	Net Profit	m	4,241	5,542	6,602	7,513
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	1,404	1,164	1,253	1,291	Reported Earnings	m	4,241	5,542	6,602	7,513
Adjusted Earnings	m	1,412	1,164	1,253	1,291	Adjusted Earnings	m	4,267	5,542	6,602	7,513
EPS (rep)		1.05	0.87	0.94	0.97	EPS (rep)		3.18	4.16	4.96	5.64
EPS (adj)		1.06	0.87	0.94	0.97	EPS (adj)		3.20	4.16	4.96	5.64
EPS Growth yoy (adj)	%	110.9	29.9	29.9	29.9	EPS Growth (adj)	%	110.9	29.9	19.1	13.8
						PE (rep)	x	18.9	14.5	12.2	10.7
						PE (adj)	x	18.8	14.5	12.2	10.7
EBITDA Margin	%	10.5	11.2	11.2	11.2	Total DPS		1.50	1.60	1.80	2.20
EBIT Margin	%	7.7	8.5	8.5	8.5	Total Div Yield	%	2.5	2.7	3.0	3.6
Earnings Split	%	33.1	21.0	22.6	23.3	Weighted Average Shares	m	1,332	1,332	1,332	1,332
Revenue Growth	%	21.1	23.1	23.1	23.1	Period End Shares	m	1,332	1,332	1,332	1,332
EBIT Growth	%	89.9	35.2	35.2	35.2						
Profit and Loss Ratios						Cashflow Analysis					
		2010A	2011E	2012E	2013E			2010A	2011E	2012E	2013E
Revenue Growth	%	21.1	23.1	17.3	12.9	EBITDA	m	7,637	10,028	11,823	13,285
EBITDA Growth	%	61.4	31.3	17.9	12.4	Tax Paid	m	-619	-1,410	-1,818	-2,233
EBIT Growth	%	89.9	35.2	20.9	14.2	Chgs in Working Cap	m	9,707	-1,693	-502	-2,191
Gross Profit Margin	%	27.3	27.0	26.6	26.4	Net Interest Paid	m	0	0	0	0
EBITDA Margin	%	10.5	11.2	11.3	11.2	Other	m	177	240	250	300
EBIT Margin	%	7.7	8.5	8.7	8.9	Operating Cashflow	m	16,902	7,166	9,752	9,161
Net Profit Margin	%	5.9	6.2	6.3	6.4	Acquisitions	m	0	-4,000	-4,000	0
Payout Ratio	%	46.8	38.4	36.3	39.0	Capex	m	-9,000	-6,500	-5,500	-5,500
EV/EBITDA	x	13.1	10.0	8.5	7.6	Asset Sales	m	0	0	0	0
EV/EBIT	x	17.9	13.3	11.0	9.6	Other	m	499	570	620	695
Balance Sheet Ratios						Investing Cashflow	m	-8,501	-9,930	-8,880	-4,805
ROE	%	11.9	14.5	15.8	16.4	Dividend (Ordinary)	m	-2,275	-2,427	-2,730	-3,337
ROA	%	7.0	8.8	9.9	10.7	Equity Raised	m	0	0	0	0
ROIC	%	7.2	10.3	10.6	10.8	Debt Movements	m	559	2,635	800	880
Net Debt/Equity	%	54.9	66.8	68.3	63.3	Other	m	-931	-1,226	-1,390	-1,497
Interest Cover	x	16.4	11.2	11.6	12.7	Financing Cashflow	m	-2,648	-1,018	-3,320	-3,954
Price/Book	x	2.2	2.0	1.8	1.7	Net Chg in Cash/Debt	m	5,753	-3,781	-2,448	402
Book Value per Share		27.5	29.8	32.8	35.9	Free Cashflow	m	7,902	666	4,252	3,661
						Balance Sheet					
		2010A	2011E	2012E	2013E			2010A	2011E	2012E	2013E
						Cash	m	6,634	2,853	405	807
						Receivables	m	4,510	5,546	6,518	6,641
						Inventories	m	9,890	11,005	12,123	13,531
						Investments	m	2,636	6,636	10,636	10,636
						Fixed Assets	m	50,933	54,971	57,798	60,466
						Intangibles	m	0	0	0	0
						Other Assets	m	7,909	7,909	7,909	7,909
						Total Assets	m	82,512	88,920	95,389	99,991
						Payables	m	12,258	12,608	14,079	13,290
						Short Term Debt	m	7,274	8,001	8,801	9,681
						Long Term Debt	m	19,479	21,387	21,387	21,387
						Provisions	m	3,161	3,361	3,570	3,775
						Other Liabilities	m	3,708	3,815	3,933	4,063
						Total Liabilities	m	45,880	49,172	51,771	52,196
						Shareholders' Funds	m	36,594	39,709	43,580	47,756
						Minority Interests	m	0	0	0	0
						Other	m	38	38	38	38
						Total S/H Equity	m	36,632	39,747	43,618	47,794
						Total Liab & S/H Funds	m	82,512	88,920	95,389	99,991

All figures in INR unless noted.

Source: Company data, Macquarie Research, May 2010

## Important disclosures:

<p><b>Recommendation definitions</b></p> <p><b>Macquarie – Australia/New Zealand</b> Outperform – return &gt;5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie – Asia/Europe</b> Outperform – expected return &gt;+10% Neutral – expected return from -10% to +10% Underperform – expected return &lt;-10%</p> <p><b>Macquarie First South - South Africa</b> Outperform – expected return &gt;+10% Neutral – expected return from -10% to +10% Underperform – expected return &lt;-10%</p> <p><b>Macquarie - Canada</b> Outperform – return &gt;5% in excess of benchmark return Neutral – return within 5% of benchmark return Underperform – return &gt;5% below benchmark return</p> <p><b>Macquarie - USA</b> Outperform (Buy) – return &gt;5% in excess of Russell 3000 index return Neutral (Hold) – return within 5% of Russell 3000 index return Underperform (Sell)– return &gt;5% below Russell 3000 index return</p> <p><b>Recommendations – 12 months</b></p> <p><b>Note:</b> Quant recommendations may differ from Fundamental Analyst recommendations</p>	<p><b>Volatility index definition*</b></p> <p>This is calculated from the volatility of historical price movements.</p> <p><b>Very high–highest risk</b> – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p><b>High</b> – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p><b>Medium</b> – stock should be expected to move up or down at least 30–40% in a year.</p> <p><b>Low–medium</b> – stock should be expected to move up or down at least 25–30% in a year.</p> <p><b>Low</b> – stock should be expected to move up or down at least 15–25% in a year.</p> <p>* Applicable to Australian/NZ/Canada stocks only</p>	<p><b>Financial definitions</b></p> <p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives &amp; hedging, IFRS impairments &amp; IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends &amp; minority interests</p> <p><b>EPS</b> = adjusted net profit / efpowa* <b>ROA</b> = adjusted ebit / average total assets <b>ROA Banks/Insurance</b> = adjusted net profit /average total assets <b>ROE</b> = adjusted net profit / average shareholders funds <b>Gross cashflow</b> = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p>																																
<p><b>Recommendation proportions – For quarter ending 31 March 2010</b></p> <table><tr><td></td><td><b>AU/NZ</b></td><td><b>Asia</b></td><td><b>RSA</b></td><td><b>USA</b></td><td><b>CA</b></td><td><b>EUR</b></td><td></td></tr><tr><td>Outperform</td><td>50.55%</td><td>62.20%</td><td>42.25%</td><td>42.39%</td><td>62.16%</td><td>46.74%</td><td>(for US coverage by MCUSA, 6.53% of stocks covered are investment banking clients)</td></tr><tr><td>Neutral</td><td>36.63%</td><td>19.02%</td><td>47.89%</td><td>50.35%</td><td>31.89%</td><td>34.78%</td><td>(for US coverage by MCUSA, 9.62% of stocks covered are investment banking clients)</td></tr><tr><td>Underperform</td><td>12.82%</td><td>18.78%</td><td>9.86%</td><td>7.27%</td><td>5.95%</td><td>18.48%</td><td>(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)</td></tr></table>				<b>AU/NZ</b>	<b>Asia</b>	<b>RSA</b>	<b>USA</b>	<b>CA</b>	<b>EUR</b>		Outperform	50.55%	62.20%	42.25%	42.39%	62.16%	46.74%	(for US coverage by MCUSA, 6.53% of stocks covered are investment banking clients)	Neutral	36.63%	19.02%	47.89%	50.35%	31.89%	34.78%	(for US coverage by MCUSA, 9.62% of stocks covered are investment banking clients)	Underperform	12.82%	18.78%	9.86%	7.27%	5.95%	18.48%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)
	<b>AU/NZ</b>	<b>Asia</b>	<b>RSA</b>	<b>USA</b>	<b>CA</b>	<b>EUR</b>																												
Outperform	50.55%	62.20%	42.25%	42.39%	62.16%	46.74%	(for US coverage by MCUSA, 6.53% of stocks covered are investment banking clients)																											
Neutral	36.63%	19.02%	47.89%	50.35%	31.89%	34.78%	(for US coverage by MCUSA, 9.62% of stocks covered are investment banking clients)																											
Underperform	12.82%	18.78%	9.86%	7.27%	5.95%	18.48%	(for US coverage by MCUSA, 0.00% of stocks covered are investment banking clients)																											

## Company Specific Disclosures:

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