

# Ashok Leyland

Rs59

UPGRADE TO OUTPERFORMER

## RESULT NOTE

Mkt Cap: Rs78.5bn; US\$1.8bn

**Analyst:** Bhushan Gajaria (91-22-6622 2562; bhushan.gajaria@idfc.com)

**Result:** Q3FY11

**Comment:** Margin disappointment factored in price correction!

## Key valuation metrics

YE Mar 31 (Rs mn)	Sales	yoy chg	Net profit	EPS (Rs)	yoy chg	P/E (x)	EV/EBITDA (x)
FY09	59,803	(22.6)	1,891	1.4	(59.8)	41.5	20.8
FY10	72,444	21.1	4,232	3.2	123.8	18.5	12.2
FY11E	107,957	49.0	5,970	4.5	41.1	13.1	7.8
FY12E	129,883	20.3	7,297	5.5	22.2	10.8	6.4

## Key highlights

- Ashok Leyland's (AL) numbers for the quarter are below estimates on account of lower EBITDA margins at 7.5% (as against our estimates of 8.8%).
- AL has reported revenue growth of 22.7% to Rs22.3bn (estimates of Rs21bn), EBITDA of Rs1.66bn (estimates of Rs1.82bn) and PAT of Rs435m (estimates of Rs605m)
- While commercial vehicle volumes have grown by 14%yoy to 18437 units, it is down 25%qoq as Q2FY11 saw advance purchase prior to implementation of BS III emission norms

## AL's Commercial vehicle volumes

	Q3FY11	Q3FY10	yoy (%)	Q2FY11	qoq (%)
<b>MHCV - Passenger</b>	<b>6,674</b>	<b>5,623</b>	<b>18.7</b>	<b>6,511</b>	<b>2.5</b>
Domestic	5,180	5,062	2.3	5,435	(4.7)
Exports	1,494	561	166.3	1,076	38.8
<b>MHCV - Goods</b>	<b>11,584</b>	<b>10,210</b>	<b>13.5</b>	<b>17,926</b>	<b>(35.4)</b>
Domestic	9,605	9,417	2.0	16,658	(42.3)
Exports	1,979	793	149.6	1,268	56.1
<b>LCV</b>	<b>179</b>	<b>289</b>	<b>(38.1)</b>	<b>153</b>	<b>17.0</b>
Domestic	139	228	(39.0)	147	(5.4)
Exports	40	61	(34.4)	6	566.7

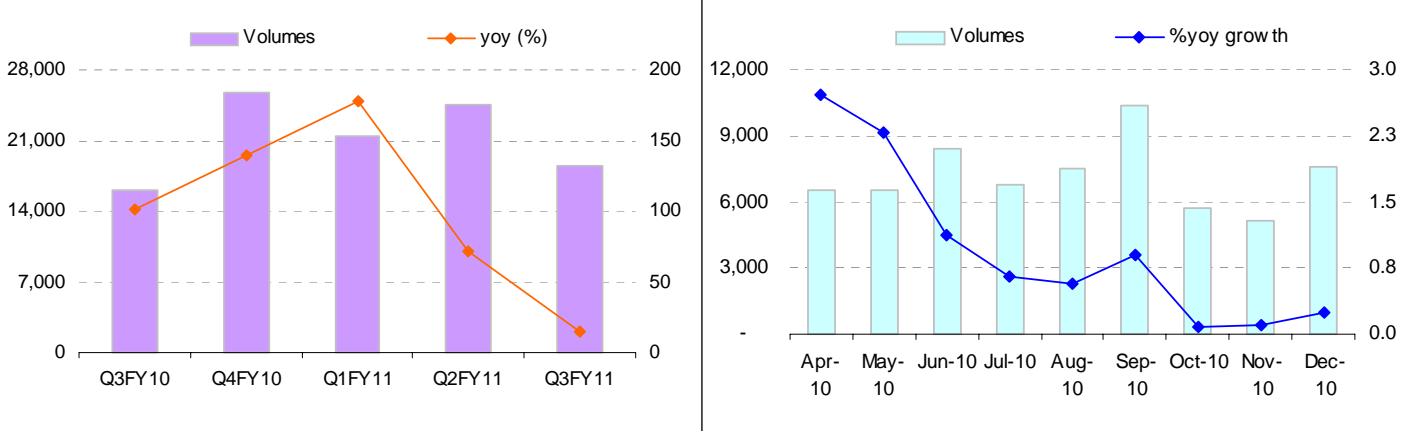
Source: IDFC Securities Research

## IDFC Securities Ltd.

Naman Chambers, C-32, G- Block, Bandra-Kurla Complex, Bandra (East), Mumbai 400 051 Tel: 91-22-6622 2600 Fax: 91-22-6622 2501  
SEBI Registration Nos.: INB23 12914 37, INF23 12914 37, INB01 12914 33, INF01 12914 33.

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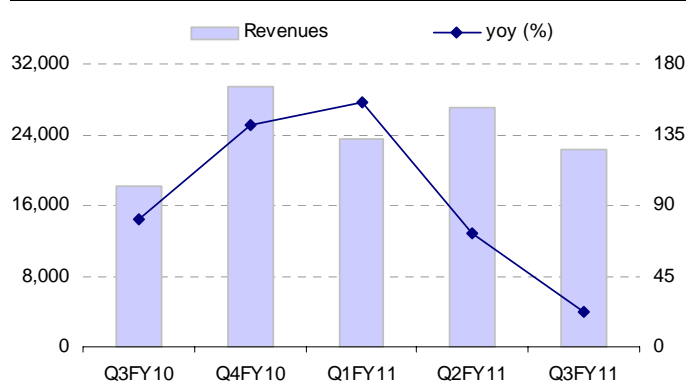
Volume growth moderates



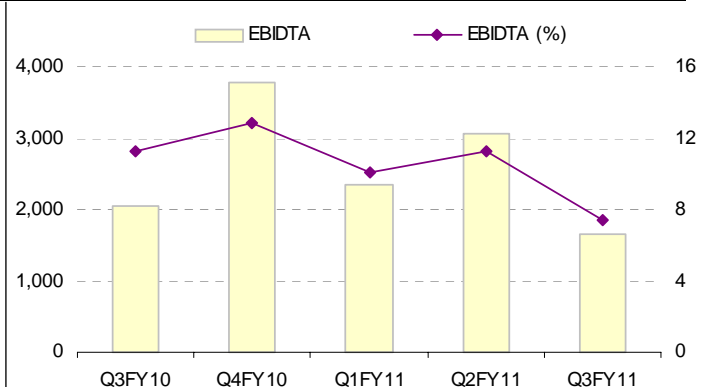
Source: IDFC Securities Research, SIAM

- Manufactured Engine volumes stood at 3000 units in Q3FY11 and total engine sales stood at 3800 units
- Price increase of 3% in October and higher sales of BS III compliant vehicles (3% price differential to BS II compliant) has helped realization grow by 9.5% on QoQ basis to Rs1.2m / vehicle (despite higher contribution from low value passenger vehicle sales)

Revenue growth at 22.7%



Margins drop to 7.5%



Source: IDFC Securities Research

- EBITDA margins have contracted by 380bp on QoQ basis to 7.5%. EBITDA per vehicle is down from Rs124547 in Q2FY11 to Rs90051 in Q3FY11
- With material cost per vehicle increasing by 8.8% to Rs0.88m (lower growth than realization increase), material cost to sales ratio dropped by 40bp to 73.2% (our estimates of 73.2%)
- AL has taken further price increase of Rs20000/ vehicle on an average in January 2011 and this will help address the material cost concern – tyre, forging and castings
- Employee costs on QoQ basis have increased by 15% to Rs2.4bn. This is partially on account of one time bonus payouts and ex gratia payment (Rs260m of payment). Also there has been an increase in headcount.
- With volumes dropping on a QoQ basis, other expenditure has dropped by 5.7% to Rs1.88bn

## Per Vehicle Analysis

	Q3FY11	Q3FY10	yoy (%)	Q2FY11	qoq (%)
Realization	1,208,030	1,126,120	7.3	1,103,680	9.5
Material Cost	883,748	803,864	9.9	812,082	8.8
Employee Cost	132,301	107,691	22.9	86,007	53.8
Other Overheads	101,931	86,652	17.6	81,045	25.8
<b>EBITDA</b>	<b>90,051</b>	<b>127,912</b>	<b>(29.6)</b>	<b>124,547</b>	<b>(27.7)</b>

Source: IDFC Securities Research

- Interest cost has increased from Rs395m in Q2FY11 to Rs475m in Q3FY11 as higher inventory and receivables of Rs4bn from State Transports resulted in higher working capital debt. AL has debt of Rs30bn on the books. Debt is expected to reduce from here as AL liquidates the inventory and brings down the receivables.
- Non operating income stood at Rs17m
- Production from Pantnagar is scaling up with AL having produced 4000 vehicles in Q3FY11 and 3000 vehicles in January 2011
- AL would be incurring capex of Rs10bn in FY11 and FY12

### □ Growth and margin outlook

With Q2FY11 witnessing sharp growth momentum on the back of preponement of purchases prior to implementation of BSIII and base effect impact, AL witnessed deceleration in growth in Q3FY11 – down from 72% growth in Q2FY11 to 14% in Q3FY11. While we expect the sales to improve sharply on QoQ basis in Q4FY11 (expect volumes of 29000 vehicles – 93500 for the year FY11), we see volume growth for AL stabilizing at 14-15% in FY12. On the margins front, given AL's high sensitivity to volumes, margins contracted sharply in the current quarter. However, as we expect volumes of 29000+ in Q4FY11 (57% growth QoQ), we see AL ending the year with margins of 10.8% in FY11. Further margin expansion in FY12 would come in on the back of increased volumes from Pantnagar facility (~Rs30,000 savings per vehicle). While we remain structurally positive on Indian commercial vehicle growth cycle, key monitorable in the near term would be IIP growth and increasing interest rates.

### Valuations and view

**With 14% volume growth and 20bp of margin expansion expectation in FY12, we see AL's EPS at Rs5.5. Recent stock price correction of 30% also puts to rest valuation concerns. With stock trading at 10.8x FY12E earnings, we upgrade our call on AL to Outperformer. Our price target of Rs71 offers 22% returns from the current level. Upgrade to Outperformer.**

## Ashok Leyland - quarterly results

Year to 31 March (Rs m)	Q3FY10	Q4FY10	FY10	Q1FY11	Q2FY11	Q3FY11	FY11E	Comment
<b>Revenues</b>	<b>18,155</b>	<b>29,390</b>	<b>72,444</b>	<b>23,480</b>	<b>27,140</b>	<b>22,272</b>	<b>107,957</b>	Realization growth of 9.5% QoQ and volume growth of 14%yoy
<i>yoy change (%)</i>	80.7	141.3	21.1	155.8	72.1	22.7	49.0	
<b>Operating Profit</b>	<b>2,053</b>	<b>3,780</b>	<b>7,591</b>	<b>2,354</b>	<b>3,063</b>	<b>1,660</b>	<b>11,704</b>	Lower volumes and Rs260m of higher employee cost provisioning
OPM (%)	11.3	12.9	10.5	10.0	11.3	7.5	10.8	
Other income	20	23	704	47	48	17	135	
Interest	162.1	221.1	811.3	316.2	394.8	474.6	1,708.2	Working capital increase on account of higher inventory and Rs4bn of receivables from STUs
Depreciation	513	588	2,041	615	641	647	2,575	
VRS compensation	-	-	-	-	-	-	-	
Profit before tax	1,397	2,994	5,443	1,470	2,075	555	7,557	
Tax	351	768	1,211	244	405	122	1,587	
<b>PAT</b>	<b>1,046</b>	<b>2,227</b>	<b>4,232</b>	<b>1,226</b>	<b>1,671</b>	<b>434</b>	<b>5,970</b>	
<i>yoy change (%)</i>	453.9	307.0	123.8	1,478.4	88.5	(58.5)	41.1	
Extraordinary items			-				-	
<b>Net profit</b>	<b>1,046</b>	<b>2,227</b>	<b>4,232</b>	<b>1,226</b>	<b>1,671</b>	<b>434</b>	<b>5,970</b>	
NPM (%)	5.8	7.6	5.8	5.2	6.2	1.9	5.5	
<i>yoy change (%)</i>	453.9	307.0	123.8	1,478.4	88.5	(58.5)	41.1	
Cash profit	1,559	2,814	6,273	1,841	2,311	1,081	8,545	
Other income/PBT	1.4	0.8	12.9	3.2	2.3	3.0	1.8	
Outstanding shares (m)	1,330.3	1,330.3	1,330.3	1,330.3	1,330.3	1,330.3	1,330.3	
EPS (Rs)	0.8	1.7	3.2	0.9	1.3	0.3	4.5	
Cash EPS (Rs)	1.2	2.1	4.7	1.4	1.7	0.8	6.4	

## IDFC Securities

Analyst	Sector/Industry/Coverage	E-mail	Tel. +91-22-6622 2600
Pathik Gandotra	Head of Research; Financials, Strategy	pathik.gandotra@idfc.com	91-22-662 22525
Shirish Rane	Construction, Power, Cement	shirish.rane@idfc.com	91-22-662 22575
Nikhil Vora	FMCG, Media, Mid Caps, Education, Exchanges	nikhil.vora@idfc.com	91-22-662 22567
Nitin Agarwal	Pharmaceuticals, Real Estate	nitin.agarwal@idfc.com	91-22-662 22568
Chirag Shah	Metals & Mining, Telecom, Pipes, Textiles	chirag.shah@idfc.com	91-22-662 22564
Bhoomika Nair	Logistics, Engineering	bhoomika.nair@idfc.com	91-22-662 22561
Hitesh Shah, CFA	IT Services	hitesh.shah@idfc.com	91-22-662 22565
Bhushan Gajaria	Automobiles, Auto ancillaries, Retailing	bhushan.gajaria@idfc.com	91-22-662 22562
Salil Desai	Construction, Power, Cement	salil.desai@idfc.com	91-22-662 22573
Ashish Shah	Construction, Power, Cement	ashish.shah@idfc.com	91-22-662 22560
Probal Sen	Oil & Gas	probal.sen@idfc.com	91-22-662 22569
Chinmaya Garg	Financials	chinmaya.garg@idfc.com	91-22-662 22563
Abhishek Gupta	Telecom, Metals & Mining	abhishek.gupta@idfc.com	91-22-662 22661
Ritesh Shah	Pharmaceuticals	ritesh.shah@idfc.com	91-22-662 22571
Saumil Mehta	Metals, Pipes	saumil.mehta@idfc.com	91-22-662 22578
Vineet Chandak	Real Estate	vineet.chandak@idfc.com	91-22-662 22579
Kavita Kejriwal	Strategy, Financials	kavita.kejriwal@idfc.com	91-22-662 22558
Anamika Sharma	IT Services	anamika.sharma@idfc.com	91-22-662 22680
Varun Kejriwal	FMCG, Mid Caps	varun.kejriwal@idfc.com	91-22-662 22685
Swati Nangalia	Media, Education, Exchanges, Midcaps	swati.nangalia@idfc.com	91-22-662 22576
Nikhil Salvi	Construction, Power, Cement	nikhil.salvi@idfc.com	91-22-662 22566
Dharmendra Sahu	Database Analyst	dharmendra.sahu@idfc.com	91-22-662 22580
Rupesh Sonawale	Database Analyst	rupesh.sonawale@idfc.com	91-22-662 22572
Dharmesh R Bhatt, CMT	Technical Analyst	dharmesh.bhatt@idfc.com	91-22-662 22534
Equity Sales/Dealing	Designation	E-mail	Tel. +91-22-6622 2500
Naishadh Paleja	MD, CEO	naishadh.paleja@idfc.com	91-22-6622 2522
Paresh Shah	MD, Dealing	paresh.shah@idfc.com	91-22-6622 2508
Vishal Purohit	MD, Sales	vishal.purohit@idfc.com	91-22-6622 2533
Nikhil Gholani	MD, Sales	nikhil.gholani@idfc.com	91-22-6622 2529
Sanjay Panicker	Director, Sales	sanjay.panicker@idfc.com	91-22-6622 2530
Rajesh Makharia	Director, Sales	rajesh.makharia@idfc.com	91-22-6622 2528
Nirbhay Singh	SVP, Sales	nirbhay.singh@idfc.com	91-22-6622 2595
Suchit Sehgal	AVP, Sales	suchit.sehgal@idfc.com	91-22-6622 2532
Pawan Sharma	MD, Derivatives	pawan.sharma@idfc.com	91-22-6622 2539
Jignesh Shah	AVP, Derivatives	jignesh.shah@idfc.com	91-22-6622 2536
Sunil Pandit	Director, Sales trading	sunil.pandit@idfc.com	91-22-6622 2524
Mukesh Chaturvedi	SVP, Sales trading	mukesh.chaturvedi@idfc.com	91-22-6622 2512
Viren Sompura	SVP, Sales trading	viren.sompura@idfc.com	91-22-6622 2527
Rajasheshkar Hiremath	VP, Sales trading	rajasheshkar.hiremath@idfc.com	91-22-6622 2516

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