Ashok Leyland

Awaits the next leg of growth

26th November 2009

Key Take Away

CMP	51.2
Recommendation	Buy on dips

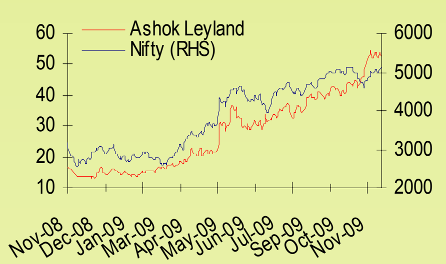
Scrip Details

Market Cap (Rs crores)	6810
P/E (x) - FY10E	21.8
Equity Capital (Rs crores)	133.0
Face Value (Rs)	1.0
52 Week High/Low (Rs)	54.9 / 12.45
Website: www.ashokleyland.com	
NSE Code	ASHOKLEY
Sensex	16810
Nifty	5002

Shareholding Pattern (%)

As on September 2009	%
Promoters	52
MFs, FIs & Banks	20.81
Total foreign (FIIs, ADR/GDR)	10.99
Central Govt / State Govt	0.10
Other Bodies corporate	2.47
Public and others	13.6

Comparative Price Movement



Sr. Analyst : Sejal Jhunjhunwala
Email: sejal@way2wealth.com
Contact: 022 – 40192918

Ashok Leyland (ALL) although has showed a lagged performance in respect to the underlying industry's turnaround, we are of the view that the company will match the pace with its potential earning outlook in H2FY10. H2FY10 looks more promising as certain positives would come into play. The incremental growth is seen from the bulk of its order book execution, which is to take place in H2FY10. Additionally, the commissioning of its Uttarkhand Plant during Jan 2010 would allow it excise duty benefits and income tax benefits, easing the pressure on its bottomline. It should be noted that while the YoY growth would be on a low base, we are factoring in a higher growth for H2FY10 as replicated in our estimates given below. Buy on declines.

KEY POSITIVES

Industry - ***On the volume front:*** The Commercial Vehicle (CV) industry has seen a growth of 5.4% YoY during April – October 2009. The main contribution was from the LCV segment (up by ~23%), whilst both the passenger and goods segment of the M&HCV saw a decline of 8.1% and 11.9% respectively. Export growth was also negative at -31%. The bus segment of the CV industry is inclusive of the private bus market and the State transport undertakings (STU). In Q2FY10, the private bus market off take saw a jump of ~16%, while the STU segment saw a decline of 49%. Among truck market, all the segments (Haulage, Tractors, MAV & ICV) witnessed growth with the exception of the Tipper segment, which saw a decline of 46% in Q2FY10.

Since the month of July 2009 the M&HCV industry has witnessed a turnaround with the improvement in off take. A key-supporting factor has been the freight rates of the cement, iron ore, fertilizer and steel sectors, which has signaled an optimistic scenario for the industry. An indicator of the same is reflective from the IIP index, which has been on an up trend from 1.1% in April 2009 to 9.1% in September 2009, after reaching 11% in August 2009, reviving the industry sentiments. As we move ahead, the IIP number is expected to rise further on account of the low base of last year.

Volume Outlook:

- The STU segment would show rapid growth in H2FY10, as the volumes under the JNNURM would be delivered during this period. JNNURM orderbook size is at 12015 units wherein only 10.3% ie 1238 units have been executed til date. ALL has executed 54% of the same. The balance comprising 89.7% of the orderbook ie 10777 units forms the unexecuted portion which is to be delivered during H2FY10. ALL's portion of the unexecuted orderbook stands at 47.2%. The truck segment would be showing a higher growth on account of the low base of last year.

- The Emission norms are being upgraded for the industry. Current emission standards stand at Euro I & II. These emission standards are being upgraded to Euro III & IV which would involve an incremental cost for the manufacturers. The timeline for the same has been set for April 2010. Therefore in anticipation of a price hike, it is expected that most of the Q1FY11 purchases would be preponed in Q3FY10 & Q4FY10 itself.

- The NHAI project, which enumerates the infrastructure plan of the government, also supports the upswing in the CV cycle as ~65% of the same (denoted as kms) are still to be completed. Infact NHAI has awarded contracts to the tune of Rs 6580 cr in Q2FY10, which are yet to be implemented. Around 40% of the contracts is in the Southern region, which would imply a recovery in the underperforming region.

- The auto finance market which is estimated at ~Rs40,000 crore has shown a pick up in the past few months. Credit concerns have diminished with operators being able to retrieve credit at lower rates. Infact, there has been a renewed interest among banks in the auto loan area, especially ICICI Bank which plans to re- enter the truck loan market.

Key Downside risks:

- Lower than estimated growth in the CV cycle

- Lower than estimated growth in the freight rates pertaining to coal, iron ore and steel.

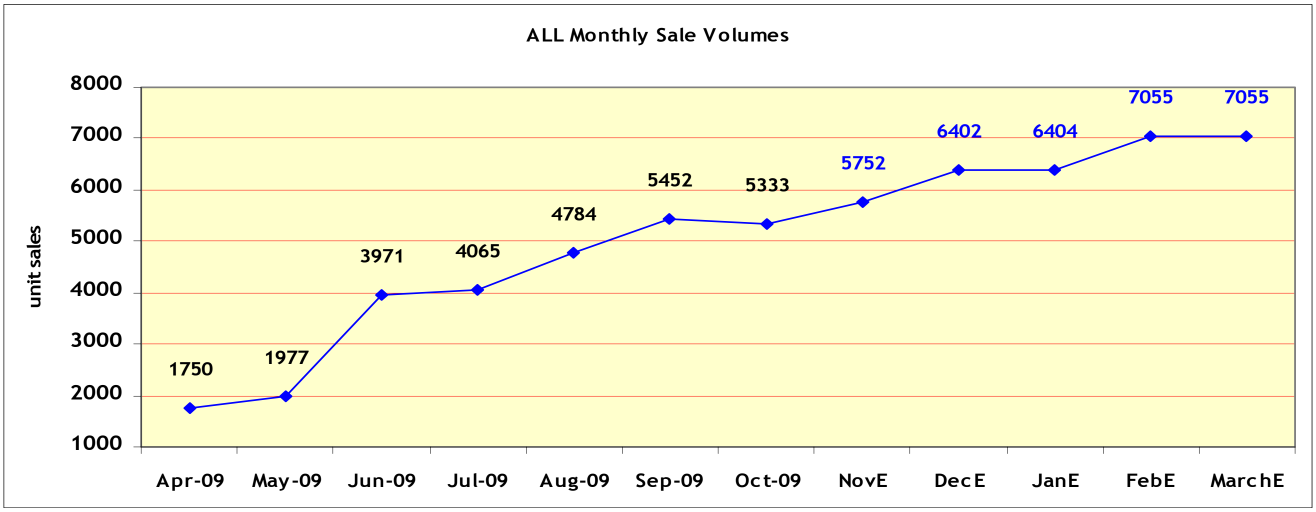
- Roll back of excise duty in the upcoming budget would hit the manufacturers, which they would not be in a position to pass on the same.

- Hardening of the interest rate would impact the credit availability and would pull down the volumes.

ALL – *On the volume front:* If we have a look at the MoM unit sale numbers, the company's total unit sales have started showing an improvement mainly from the month of August. The domestic sales have picked up as indicative from a monthly average run rate of 4202 units in Q2FY10 as compared to 2265 units in Q1FY10. Monthly average run rate for H1FY10 is at 1628 units. On the export front, the monthly average run rate has improved from 301 units in Q1FY10 to 565 units in Q2FY10. However, export growth has turned negative in October. H1FY10 export performance witnessed a 21% decline on a YoY basis mainly on account of the decline from the Middle East countries. On account of a recovery in its unit sales, the market share of the company has improved on a MoM basis in both the truck and bus segments as shown below.

Month	ALL Bus	Market Share (%)	ALL Truck	Market Share (%)	Total	Market Share (%)
April 09	596	26.5	995	11.3	1591	14.4
May 09	599	25.1	1044	10.7	1643	13.5
June 09	1016	35.8	2412	18.8	3428	21.9
July 09	974	35.5	2516	18.8	3490	21.6
Aug 09	1281	40.2	2880	19.7	4161	23.4
Sept 09	1392	40.7	3371	19.4	4763	22.9
Oct 09	1451	44.1	3400	21.2	4851	25.1

Source: Company, W2W Research



Source: Company, W2W Research

Volume Outlook:

- The company has an orderbook of 8500 buses out of which ~41% comprises of orders from STU's (Incl of JNNURM). Most of the JNNURM orderbook would be executed in H2FY10, which would push up the monthly average run rate for the company. Currently, the company's monthly run rate considering the period from July-October 2009 is at 4900 units. The run rate for Q3FY10 is expected to be ~6500 units and for Q4FY10 is expected to be ~8000 units as per the guidance given by the management. If we consider the above mentioned run rates we would arrive at a H2FY10 volume target of 43500 units and FY10 volume target of 70823 units. But the company has given a FY10 volume target of 62000-63000 units, domestic sales being 58,000 units and exports being ~7500 units. Considering the fact that at the peak of the cycle ie during FY08 the company's volume sales were 83000, a target of 62000-63000 units doesn't seem over ambitious. But whilst we are positive on the domestic story we are not that positive on the export front. The company has expressed its interest in entering new export markets such as Brazil and Chile, but we are of the view that an export target of 5000 units for H2FY10 is steep as it implies a monthly average run rate of atleast 800 units. Therefore we have revised our FY10 volumes to 60,000 units, which imply an average monthly run rate of 6533 units from November 09 – March 10. The run rates and the corresponding estimated figures are shown in the chart above. As per our estimates, H2FY10 volume growth implies an increase of 102%, which ofcourse is also because of the low base of last year. One point to note is that the company has an inventory of ~6300 units as on date and is expected to liquidate the same before April 2010.

- The company's facility at Uttarkhand would be operational from Jan 2010. The initial volume target from this facility is at 2000-3000 units, with capacity being ramped up to 30,000 units by April 2010 and to 50,000 units by FY11. This facility would be retrieve excise duty benefits for a period of 5 years and 100% income tax exemption for a period of 5 years. The company's capacity level is being ramped up from the current 100,000 units to 1,50,000 units by FY11 with the commissioning of its Uttarkhand plant. The company would also benefit from logistics for supply to the North, East and Western markets. We expect incremental volumes coming from the Uttarkhand plant, which would account for additional benefits and ease the pressure on the bottomline. The incremental volumes from the Uttarkhand plant is estimated to have a per unit savings of ~Rs 60,000 for the company. The plant is a fully integrated plant with localization levels expected to be at 70%-80% for FY11, leading to margin expansion.

Key Downside Risks:

- Any delay in the commissioning of the Uttarkhand plant may warrant a decline in our volume estimates
- Additionally, the excise duty rollback expected in the upcoming budget would impact the company if it doesn't manage to offset the same with volumes from Uttarkhand plant.
- Inventory of ~6300 units would have to be cleared out before April 2010, else it may lead to a loss of market share for the company
- Any delay in order book execution or a reversal in the CV cycle would impact the company for H2FY10

Financials

ALL Sale Volumes	Q2FY10	Q2FY09	% Chg YoY	Oct -09	% Chg MoM	April09-Oct09	April08-Oct08	% Chg YoY
MDV Pass	4192	6718	-37.6	1567	-2.0	8244	12712	-35.1
MDV Goods	9855	10261	-3.9	3673	-2.7	18477	25793	-28.4
LCV Goods	254	228	11.4	93	16.3	602	524	14.9
Total	**14301**	**17207**	**-16.9**	**5333**	**-2.2**	**27323**	**39029**	**-30.0**
Domestic Sales	12606	15181	-16.9	4934	2.5	24326	35302	-31.1
Exports	1695	2026	-16.3	399	-37.6	2997	3727	-19.6

ALL Results - Rs cores	H1FY10	H1FY09	% Chg YoY	H2FY10E	H1FY10	% Chg	FY10E	% Chg YoY
Volume sold (units)	***21994***	***35632***	***-38.3***	***38006***	***21994***	***73***	***60000***	***10.2***
Net Sales	**2490.1**	**3758.5**	**-33.7**	**4110**	**2490.1**	**65.0**	**6600**	**10.3**
Total Expenditure	2311.9	*3492.3*	-33.8	3654.9	2311.9	58.0	5966.8	8.3
Operating Profit	178.2	*266.2*	-33.1	455	178.2	155	633.2	34.9
OPM(%)	***7.2***	***7.1***		***11.0***	***7.2***		***9.6***	
PBT	**105.6**	***160.9***	**-34.4**	**262.6**	**105.6**	**149**	**368.2**	**76.6**
PBT(%)	***4.3***	***4.5***		***6.4***	***4.3***		***5.6***	
PAT	**96.4**	***117.8***		**216.6**	**96.4**	**125**	**313**	**64.7**
PAT(%)	***3.9***	***3.1***		***5.3***	***3.9***		***4.7***	
Equity Share Capital	133.0	*133.0*		133.0	133.0		133.0	
EPS	0.72	*0.89*		1.63	0.72		2.35	

Source: Company, W2W Research

Key Remarks:

- Volume guidance given by the management: 62000 – 63000 units for FY10
- Operational Margin – The company had taken a pricing action of 2% in the month of July 2009 which was actualized in August and September. Further on it took a pricing action of 1.5% in October, which would be actualized in November and December. The company has maintained its target of a 10% OPM for FY10.
- Interest cost pressure eases with the reduction in working capital from Rs 1090 cr in March 09 to Rs 885 cr in Q2FY10.
- Current Inventory stands at 6300 units, brought down from 12000 in September 08. Going forward, the inventory would have to be liquidated before April 2010.
- Capex plans of the company stands at Rs 2000 cr for FY10, FY11 & FY12. Rs 350 cr has already been undertaken in H1FY10. It also has investments of Rs 800 cr which would be inclusive of the investment for its Uttarkhad facility.
- Current Debt Position – Rs 1400 cr wherein working capital loan is Rs 400 cr and term loans form the balance.

Estimates:

- We have factored in a volume jump of 10.2% for FY10. **(As covered in ALL – volume outlook given above).-** One major trigger would be the pre pone of the Q1FY11 M&HCV purchases as the change in emission norms from April 2010 would bring upon an incremental cost for the manufacturers to the tune of ~Rs 300 – Rs 400cr and for a consumer it would be an additional investment of ~Rs 40,000 cr.

- As per our estimates the OPM for FY10 is at 9.6% taking into account the estimated volume growth and price action which would be actualized in November and December. Though the company would face margin pressure post December due to the uptick in the commodity prices, we are of the view that the growth in volumes would help offset the increase in the RM cost.

- We have factored in a higher personnel expense for FY10 as ALL's Uttarkhand facility would be operational from Jan 2010.

- Interest cost would increase in Q4FY10 with the commissioning of the Uttarkhand plant

- With an addition of Rs 1000 crore to the gross block on account of the Uttarkhand plant, we would see a higher depreciation in H2FY10. Additionally, as the company's depreciation methodology is on shift basis. As the number of shifts of plants increases, the charge increases.

- Once the company's Uttarkhand plant operates at its maximum capacity, (initial target – 3000 units, April 2010 – 30,000 and FY11- 50,000) the tax rate would be brought down as the plant enjoys a 100% income tax benefit for 5 years. ALL would be targeting incremental volumes from this plant so as to reap the benefits of excise duty and income tax.

- The company has a comfortable Debt:Equity position of 0.8x:1. It plans to borrow around Rs 500 cr in H2FY10 which would still keep it below the 1x:1 d/e level. **We are of the view that the company may go in for an equity raising during H2FY10.**

Key Upside Risk:

(Note – As per our recent interaction we have come to know that the introduction of GST would not alter the excise duty benefits the company would retrieve from its Uttarkhand plant, but basically create uniformity of the service/sales tax which varies across states.)

Recommendation: **The stock quotes at a P/E of ~22x its FY10E earnings of Rs 2.35. Though the stock is trading near its historical highs we are positive on the company for the next 5-6 months given the anticipated order book execution and the recovery in the CV cycle. Additionally, the commissioning of the Uttarkhand plant would help the company avail the excise duty and income tax benefits and ease the pressure on the bottomline. De-risking of the business model by increasing the contribution from buses, defence, engines and spare parts from 42% to 50% in H1FY10 has augured well for the company. Going forward these segments would provide a thrust to the earnings.**

Since the stock has already moved higher we advice our investors to buy on declines. An attractive entry point would be at the level of Rs 48.

RESEARCH TEAM

K.N.Rahaman	Deputy Research Head	Equities & Commodities	rahaman@way2wealth.com
Krishna Reddy	Research Analyst	Commodities, Economic Update	krishnareddy@way2wealth.com
Nisha Harchekar	Sr. Research Analyst	Banking, FMCG, Entertainment	nishaharchekar@way2wealth.com
Sejal Jhunjhunwala	Sr. Research Analyst	Transportation (Auto, Shipping, Aviation, Port etc), Metals	sejal@way2wealth.com
Pinkesh Jain	Sr. Research Analyst	Infrastructure, Real Estate, Cement, Metals & mining	pinkesh@way2wealth.com
Vishwa Doshi	Research Analyst	IT, Telecom	vishwadoshi@way2wealth.com
Prateek Jain	Sr. Research Analyst	Mutual Funds & Economic update	prateek@way2wealth.com
Aditya Agarwal	Sr. Derivative Analyst	Derivative Strategist & Technicals	aditya@way2wealth.com
Amrut Deshmukh	Sr. Technical Analyst	Technical Analysis	amrut@way2wealth.com
Parag Joshi	Technical Analyst	Technical Analysis - Commodities	paragjoshi@way2wealth.com
Rupali Prabhu	Assistant to Research	Database Management	rupali@way2wealth.com
Contact		**022-40192900**	

DISCLAIMER