



Ashok Leyland

STOCK INFO.	BLOOMBERG
BSE SENSEX: 18,493	AL IN
	REUTERS CODE
S&P CNX: 5,474	ASOK.BO

23 October 2007

Buy

Previous Recommendation: Buy

Rs38

Equity Shares (m)	1,331.8
52-Week Range	51/34
1,6,12 Rel. Perf. (%)	-17/-32/-64
M.Cap. (Rs b)	50.3
M.Cap. (US\$ b)	1.3

YEAR	NET SALES	PAT	EPS	EPS	P/E	P/BV	ROE	ROCE	EV/	EV/
END	(RS M)	(RS M)	(RS)	GROWTH (%)	(X)	(X)	(%)	(%)	SALES	EBITDA
3/07A	71,682	4,276	3.2	41.4	11.7	2.6	23.3	22.8	0.7	7.1
3/08E	82,727	4,482	3.4	4.8	11.2	2.4	21.9	18.2	0.7	6.5
3/09E	93,029	4,997	3.8	11.5	10.1	2.1	21.2	18.9	0.6	5.8

- Ashok Leyland 2QFY08 profits were in line with expectations. EBITDA margin improved 150bp YoY (v/s our expectation of 90bp YoY improvement).
- Net sales growth of 4.2% YoY to Rs17.5b was driven by 9.6% higher realizations, even though volumes declined 4.9% YoY. The increase in realization was on account of higher sales of spare parts and sale of 300 units to Vehicle Factory, Jabalpur (nil in 2QFY07).
- EBITDA margin (adjusted for a forex gain of Rs46m) improved 150bp to 9.4%. The EBITDA margin improvement was aided by lower RM/sales ratio at 72.8% (v/s 75.6% in 2QFY07) and lower other expenditure/net sales at 8.6% (v/s 9.4% in 2QFY07 and 9.9% in 1QFY08). As a result, EBITDA increased by 24.1% YoY to Rs1.6b.
- Higher working capital in 1HFY08 led to the interest cost being substantially higher at Rs126m. Due to the higher interest cost and higher other income, adjusted PAT increased by 9.4% YoY to Rs784m.
- The company has guided for CV volumes of 90,000 units in FY08, while targeting an EBITDA margin of 10%. We maintain our volume estimates of 8% growth in FY08 and 9% in volume growth in FY09. Our EPS estimate for FY08 remains unchanged at Rs3.4. The stock trades at 11.2x FY08 EPS of Rs3.4 and 10.1x FY09 EPS of Rs3.8. Maintain **Buy**.

QUARTERLY PERFORMANCE

(Rs Million)

	FY07				FY08				FY07	FY08E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Total Volumes (nos)	17,040	19,869	20,068	26,124	18,163	18,892	22,500	30,194	83,101	89,749
Net Sales	14,239	16,757	17,776	22,910	16,211	17,459	21,126	27,931	71,682	82,727
Change (%)	33.9	34.0	47.8	32.3	13.9	4.2	18.8	21.9	36.6	15.4
Total Cost	13,026	15,437	15,907	20,314	14,665	15,820	19,013	24,790	64,685	74,289
EBITDA	1,213	1,320	1,869	2,596	1,546	1,639	2,113	3,141	6,997	8,438
As a % of Sales	8.5	7.9	10.5	11.3	9.5	9.4	10.0	11.2	9.8	10.2
Change (%)	41.4	10.3	61.0	20.6	27.5	24.1	13.1	21.0	30.3	20.6
Non-Operating Income	139	99	64	169	76	111	70	145	470	401
Interest	5	4	26	19	128	126	130	135	53	519
Gross Profit	1,346	1,415	1,907	2,746	1,494	1,624	2,053	3,150	7,414	8,320
Less: Depreciation	328	365	332	481	413	466	480	493	1,506	1,852
PBT	1,019	1,050	1,574	2,264	1,081	1,158	1,573	2,657	5,908	6,468
Tax	262	334	463	573	361	374	464	787	1,632	1,986
Effective Tax Rate (%)	25.7	31.8	29.4	25.3	33.4	32.3	29.5	29.6	27.6	30.7
Adj. PAT (before extraordinary)	756	716	1,112	1,692	720	784	1,109	1,870	4,276	4,482
Change (%)	126.1	-10.7	96.5	28.0	-4.8	9.4	-0.3	10.5	41.4	4.8
Extraordinary Income	0	268	0	54	197	46	0	0	322	243
Extraordinary Loss	65	31	59	30	35	27	0	0	185	61
Rep. PAT	692	954	1,053	1,715	882	803	1,109	1,870	4,413	4,664
Change (%)	7.5	27.1	93.1	28.5	27.5	-15.8	5.3	9.0	34.8	5.7

E: MOST Estimates

Volume growth slows down

The industry volumes in the goods M&HCV segment slowed down significantly in 2QFY08 due to higher interest rates and the high base of the previous year. The industry sales in the M&HCV goods segment declined 13.5%, while those for Ashok Leyland declined by 24.7%. While sales in 1Q were negatively impacted by problems of cab availability for its tractor trailers, the problem has been resolved in 2Q, and the company is not facing any more shortages on this count.

Overall, M&HCV sales of ALL for the quarter declined 5.2%, against a decline of 4.2% registered in volumes by the industry. Volumes in 2Q were mainly driven by the increased offtake of buses by STUs and demand from private bus operators (bus sales increased by 77% YoY). The management had indicated in the previous fiscal that it had flexibility in delivery of buses to STUs and had postponed the servicing of this demand to FY08. Overall volumes of ALL decreased by 4.9% YoY to 18,892 units.

We maintain a long-term positive view on CV sales; over the medium to long term, CV sales will be driven by the structural drivers in the economy such as highway development, industrial growth, increased availability of freight, improvement in road networks, etc. We believe the decrease in CV financing interest rates seen over the past three months will have a positive impact on volumes next quarter onwards. For ALL, We expect 8% growth in volumes in FY08 and 9% growth in FY09.

PASSENGER SEGMENT SALES PICK UP

	2QFY08	2QFY07	% CHG	1QFY08	% CHG
Volume (units)					
HCV - Goods	12,061	16,010	-24.7	12,876	-6.3
HCV - Passenger	6,684	3,771	77.2	5,128	30.3
Total HCV	18,745	19,781	-5.2	18,004	4.1
LCV	147	88	67.0	159	-7.5
Total Sales	18,892	19,869	-4.9	18,163	4.0
of which Exports	1,563	1,599	-2.3	1,424	9.8

Source: Company/Motilal Oswal Securities

ALL: PRODUCT MIX

	2QFY08	2QFY07	1QFY08
% of Total			
HCV - Goods	63.8	80.6	70.9
HCV - Passenger	35.4	19.0	28.2
Total HCV	99.2	99.6	99.1
LCV	0.8	0.4	0.9
Total Sales	100.0	100.0	100.0

Source: Company/Motilal Oswal Securities

Increased realizations drive sales growth

Net sales growth of 4.2% YoY to Rs17.5b is driven by 9.6% increase in realizations, even though volumes declined 4.9% YoY. The other factors which helped to improve realizations were higher sales of spare parts and sale of 300 units to Vehicle Factory Jabalpur (Defence supply), which was nil in 2QFY07.

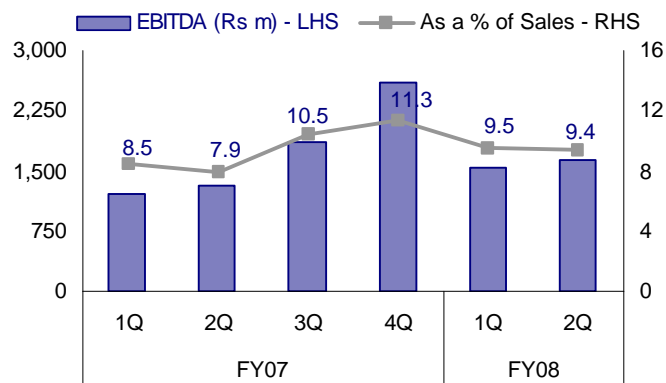
ALL has taken a price increase of ~2% in CVs in October (which will be implemented only by the month end). This will help the company to maintain realization growth through the next two quarters as well.

EBITDA margin improves

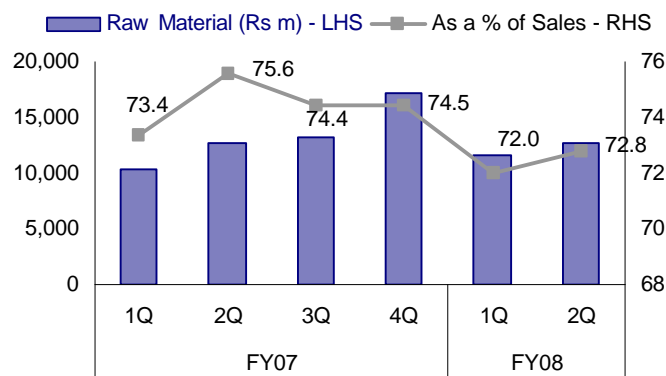
EBITDA margin (adjusted for a forex gain of Rs46m) improved 150bp to 9.4%. The EBITDA margin improvement has aided by lower RM/sales ratio at 72.8% (v/s 75.6% in 2QFY07) and lower other expenditure/net sales at 8.6% (v/s 9.4% in 2QFY07 and 9.9% in 1QFY08). Decline in other expenditure was also aided by lower power cost (mainly by using wind power) of Rs30m in 2Q and also due to the ongoing productivity improvement and cost reduction programs. As a result, EBITDA increased 24.1% YoY to Rs1.6b.

Higher working capital levels in 1HFY08 have led to the interest cost being substantially higher at Rs126m. Due to the higher interest cost and higher other income, adjusted PAT increased by 9.4% YoY to Rs784m.

EBITDA MARGIN: ABOVE EXPECTATIONS



RAW MATERIALS COSTS ARE LOWER



Source: Company/Motilal Oswal Securities

Tie-up with Nissan will boost presence in LCVs

Ashok Leyland has entered into an initial agreement to form three joint ventures with Nissan Motor Co for the development, manufacture and distribution of LCV products. The two companies may also share each others’ dealer networks in India and overseas as an extension of this partnership.

This partnership is a positive development for Ashok Leyland, as it has near-zero presence in the LCV space (LCV sales has averaged 51 units per month in 1HFY08).

ALL’s JV with Nissan for the manufacture of LCVs is targeting production of 100,000 LCVs annually for both the domestic and international markets. This move will transform ALL from a peripheral LCV player to a significant

market participant. Moreover, with the acquisition of Avia, a Czech company, last year (giving ALL a presence in MCVs), ALL will be able to boast a complete CV portfolio once the JVs with Nissan begin operations.

Investment argument

CV demand to pick up

We believe that the long-term structural factors for the CV industry are still in place. We expect ALL’s volumes to grow 8% in FY08 and 9% in FY09. Its focus on non-cyclical business segments such as vehicle and aggregate exports is expected to cushion domestic business cyclicality. The quality of earnings and earnings momentum for ALL is expected to improve in the coming quarters, aided by capacity addition and stable EBITDA margin.

Proportion of non-cyclical revenue to increase dramatically

ALL’s partnerships with Alteams and Siemens VDO and its attempts to increase the share of non-cyclicals in its revenues will result in ALL successfully broad-basing its revenues over the long run. Other attempts to venture into non-cyclicals include focus on the passenger bus segment, sale of spare parts, exports and supplies to defense. The company plans to increase the share of non-cyclicals to 30% of revenues over the next three years.

To achieve this end, ALL has acquired Detroit-based testing services firm, Defiance Testing and Engineering Services for US\$17m, which will complement ALL’s design and engineering services division and help the segment target value added business.

Avia acquisition to boost exports

Ashok Leyland has acquired Avia’s truck business, which will give it a foothold in Eastern Europe. Avia’s truck manufacturing facility has a capacity of 20,000 units. Besides boosting exports, Avia’s acquisition would also help Ashok Leyland gain a presence in ICVs (7 ton-11 ton). Ashok Leyland expects exports to constitute 25% of its total volumes by FY09, up from the 7% in FY07.

Valuation and view

The company has guided for CV volumes of 90,000 units in FY08, while targeting an EBITDA margin of 10%. We maintain our volume estimates of 8% growth in FY08 and

9% in volume growth in FY09. Our EPS estimate for FY08 remains unchanged at Rs3.4. The stock trades at 11.2x FY08 EPS of Rs3.4 and 10.1x FY09 EPS of Rs3.8. Maintain **Buy**.

Ashok Leyland: an investment profile

Company description

Ashok Leyland is the second largest commercial vehicle manufacturer in India with a product portfolio comprising passenger and goods carriers across all tonnage categories. An erstwhile regionally concentrated CV company, Ashok Leyland has made serious attempts in the last 12 months to broad base its markets.

Key investment arguments

- ✍ We remain positive on the long-term growth rate for the CV segment, due to strong industrial growth and increased focus of the government on highway development.
- ✍ While ramping up its installed capacity, ALL is also focusing on programs like e-sourcing, which will enable it attain stable operating margin in a rising cost scenario.
- ✍ ALL's focus on non-cyclical business segments such as vehicle and aggregate exports is expected to cushion domestic business cyclicality.

Key investment risks

- ✍ Increased competition in the industry with several MNC players such as ITEC and MAN entering Indian.
- ✍ Further increases in interest rates may impact demand negatively.

Recent developments

- ✍ ALL is entering into a JV with Nissan for the development, manufacture and distribution of LCV products.
- ✍ ALL has acquired Detroit-based testing services firm Defiance Testing and Engineering Services for \$17m.

Valuation and view

- ✍ We expect volumes to grow 8% in FY08 and 9% in FY09.
- ✍ The company has guided for CV volumes of 90,000 units in FY08, while targeting an EBITDA margin of 10%. We maintain our volume estimates of 8% growth in FY08 and 9% in volume growth in FY09. Our EPS estimate for FY08 remains unchanged at Rs3.4. The stock trades at 11.2x FY08 EPS of Rs3.4 and 10.1x FY09 EPS of Rs3.8. Maintain **Buy**.

Sector view

- ✍ Demand related factor of IIP production remains strong for the sector.
- ✍ Freight rates have remained firm quelling any near term fears.

COMPARATIVE VALUATIONS

		ASHOK LEY	TATA MOTORS
P/E (x)	FY08E	11.2	15.3
	FY09E	10.1	13.5
EPS Gr (%)	FY08E	4.8	-1.9
	FY09E	11.5	13.6
RoE (%)	FY08E	21.9	21.4
	FY09E	21.2	21.0
EV/EBITDA (x)	FY08E	6.5	10.3
	FY09E	5.8	9.2

SHAREHOLDING PATTERN (%)

	SEP-07	JUN-07	SEP-06
Promoter	38.7	38.9	39.3
Domestic Inst	17.3	17.8	19.6
Foreign	30.3	29.5	25.4
Others	13.7	13.8	15.7

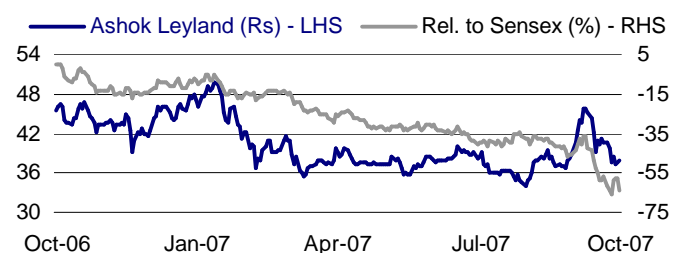
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY08	3.4	3.3	4.5
FY09	3.8	3.7	2.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
38	45	19.0	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT

Y/E MARCH	2005	2006	2007	2008E	2009E
Net Sales	41,824	52,477	71,682	82,727	93,029
Change (%)	23.3	25.5	36.6	15.4	12.5
Expenditure	37,595	47,108	64,685	74,289	83,447
EBITDA	4,228	5,369	6,997	8,438	9,582
Change (%)	7.2	27.0	30.3	20.6	13.6
% of Net Sales	10.1	10.2	9.8	10.2	10.3
Depreciation	1,092	1,260	1,506	1,852	2,306
Interest & Fin. Charges	304	384	318	741	984
Other Income	554	549	735	623	648
Non-recurring Expense	95	85	185	61	-
Non-recurring Income	260	334	322	243	-
PBT	3,386	4,274	5,908	6,468	6,940
Tax	836	1,250	1,632	1,986	1,943
Effective Rate (%)	24.7	29.2	27.6	30.7	28.0
Adj. PAT (bef. Extra	2,550	3,024	4,276	4,482	4,997
% of Net Sales	25.6	18.6	41.4	4.8	11.5
Rep. PAT	2,715	3,273	4,413	4,664	4,997

BALANCE SHEET

Y/E MARCH	2005	2006	2007	2008E	2009E
Share Capital	1,189	1,222	1,324	1,332	1,332
Reserves	10,489	12,903	17,622	19,955	22,288
Net Worth	11,679	14,125	18,946	21,287	23,620
Loans	8,804	6,919	6,404	16,404	16,404
Deferred Tax Liability	1,708	1,797	1,969	1,969	1,969
Capital Employed	22,191	22,841	27,319	39,660	41,993
Gross Fixed Assets	20,023	21,385	26,202	36,577	41,577
Less: Depreciation	11,084	11,952	13,132	14,984	17,289
Net Fixed Assets	8,938	9,433	13,070	21,593	24,288
Investments	2,292	3,682	2,211	2,211	2,211
Curr.Assets, L & Ad	21,573	22,324	26,977	35,379	37,078
Inventory	5,681	9,026	10,703	13,146	14,783
Sundry Debtors	4,588	4,243	5,229	6,034	6,786
Cash & Bank Balances	7,967	6,029	4,349	9,504	8,814
Loans & Advances	3,337	3,026	6,696	6,696	6,696
Current Liab. & Prov	11,657	14,085	17,559	19,768	21,828
Sundry Creditors	8,619	10,460	14,337	16,546	18,606
Other Liabilities	993	1,009	2,179	2,179	2,179
Provisions	2,045	2,616	1,042	1,042	1,042
Net Current Assets	9,916	8,239	9,419	15,612	15,250
Miscellaneous Exp.	193	73	244	244	244
Application of Fund:	22,191	22,841	27,319	39,660	41,993

E: Most Estimates

RATIOS

Y/E MARCH	2005	2006	2007	2008E	2009E
Basic (Rs)					
EPS	1.9	2.5	3.2	3.4	3.8
Cash EPS	3.1	3.5	4.4	4.8	5.5
EPS Growth (%)	18.3	18.6	41.4	4.8	11.5
Book Value per Share	9.8	11.6	14.3	16.0	17.7
DPS	10	13	16	19	2.2
Payout (Incl. Div. Tax) %	48.7	48.8	45.0	50.0	53.3
Valuation (x)					
P/E			11.7	11.2	10.1
Cash P/E			8.7	7.9	6.9
EV/EBITDA			7.1	6.5	5.8
EV/Sales			0.7	0.7	0.6
Price to Book Value			2.6	2.4	2.1
Dividend Yield (%)			4.3	5.0	5.8
Profitability Ratios (%)					
RoE	23.2	23.2	23.3	21.9	21.2
RoCE	16.6	20.4	22.8	18.2	18.9
Leverage Ratio					
Debt/Equity (x)	0.8	0.5	0.3	0.8	0.7

CASH FLOW STATEMENT

Y/E MARCH	2005	2006	2007	2008E	2009E
OP/(Loss) before Tax	3,136	4,109	5,491	6,586	7,276
Depreciation & Amortisæ	1,092	1,260	1,506	1,852	2,306
Direct Taxes Paid	-930	-1,161	-1,460	-1,986	-1,943
(Inc)/Dec in Working Cap	1,241	-141	-3,030	-1,039	-328
Other Items	-365	738	2,292	0	0
CF from Oper. Activ	4,174	4,805	4,799	5,413	7,311
Extra-ordinary Items	165	249	137	182	0
CF after EO Items	4,339	5,054	4,936	5,595	7,311
(Inc)/Dec in FA+CWIP	-1,671	-2,317	-6,104	-8,000	-5,000
(Pur)/Sale of Invest.	-826	-1,390	1,471	0	0
CF from Inv. Activit	-2,497	-3,707	-4,633	-8,000	-5,000
Issue of Shares	0	32	102	8	0
Inc/(Dec) in Debt	3,815	-1,885	-515	10,000	0
Interest Rec./ (Paid)	250	165	417	-118	-337
Dividends Paid	-1,189	-1,598	-1,986	-2,331	-2,664
CF from Fin. Activit	2,875	-3,285	-1,982	7,560	-3,000
Inc/(Dec) in Cash	4,717	-1,938	-1,679	5,154	-689
Add: Beginning Balance	3,250	7,967	6,029	4,349	9,504
Closing Balance	7,967	6,029	4,349	9,504	8,814

N O T E S



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Disclosure of Interest Statement

Ashok Leyland

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|---------------------------------------------------------|----|
| 1. Analyst ownership of the stock | No |
| 2. Group/Directors ownership of the stock | No |
| 3. Broking relationship with company covered | No |
| 4. Investment Banking relationship with company covered | No |

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