2QFY07 Results Update
SECTOR: AUTOMOBILES

MOTILAL OSWAL

Ashok Leyland

STOCK INFO.	BLOOMBERG
BSE Sensex: 13,033	AL IN
	REUTERS CODE
S&P CNX: 3,767	ASOK.BO

Equity Shares (m)	1,323.7
52-Week Range	54/26
1,6,12 Rel. Perf. (%)	35/-24/-8
M.Cap. (Rs b)	61.2
M.Cap. (US$ b)	1.4

1 November 2006 **Buy**

Previous Recommendation: Buy Rs44

YEAR END	NET SALES (RS M)	PAT (RS M)	EPS (RS)	EPS GROWTH (%)	P/E (X)	P/BV (X)	ROE (%)	ROCE (%)	EV/ SALES	EV/ EBITDA
3/06A	52,477	3,024	2.5	29.7	18.7	4.0	23.2	20.4	1.0	10.0
3/07E	65,119	3,905	3.0	19.2	15.7	3.8	25.1	22.5	0.8	8.6
3/08E	73,322	4,594	3.5	17.6	13.3	3.3	25.1	27.0	0.7	6.8

- Ashok Leyland (ALL) reported revenue growth of 34% YoY, driven by volume growth of 33.4% YoY and realization growth of 0.5% YoY. EBITDA grew 10.3% YoY to Rs1.3b. Margins fell 170bp YoY and 60bp QoQ due to increase in raw material to sales ratio (75.6% in 2QFY07 v/s 70.7% in 2QFY06 and 73.4% in 1QFY07). Lower staff cost and other expenditure were unable to offset the higher raw material costs. Adjusted PAT declined 11% to Rs716m due to lower than expected other income.
- ALL is making continuous efforts to broadbase its revenues by focusing on the bus segment, sale of spares, exports and defense supplies. The company plans to increase the share of non-cyclicals to more than 35% (currently estimated at 23-25%) of revenues. We remain positive on ALL's growth prospects. We expect volumes to grow by 23.5% in FY07, indicating residual growth rate of 17.2% for the balance of the year.
- We have revised our EBITDA margin assumption for FY07 to 9.8% to reflect the cost pressures being felt by the company. However, our revenue estimate has been upgraded marginally by 0.9%. As a result, our EPS estimate is lower by 10.4% for FY07 and by 6.7% for FY08. Our revised EPS estimates are now Rs3 for FY07 (earlier Rs3.3) and Rs3.5 for FY08 (earlier Rs3.7). ALL trades at 15.7x FY07E and 13.3x FY08E earnings. We maintain **Buy**.

QUARTERLY PERFORMANCE (RS MILLION)

	FY06				FY07				FY06	FY07E
	1Q	2Q	3Q	4Q	1Q	2Q	3QE	4QE		
Total Volumes (nos)	13,320	14,895	13,038	20,373	17,067	19,869	17,250	21,922	61,626	76,108
Net Sales	**10,632**	**12,501**	**12,024**	**17,319**	**14,239**	**16,757**	**15,432**	**18,691**	**52,477**	**65,119**
Change (%)	*29.5*	*36.7*	*21.8*	*18.7*	*33.9*	*34.0*	*28.3*	*7.9*	*25.5*	*24.1*
Total Cost	9,774	11,304	10,863	15,166	13,026	15,437	13,904	16,370	47,108	58,737
EBITDA	**858**	**1,197**	**1,161**	**2,153**	**1,213**	**1,320**	**1,528**	**2,321**	**5,369**	**6,382**
As a % of Sales	*8.1*	*9.6*	*9.7*	*12.4*	*8.5*	*7.9*	*9.9*	*12.4*	*10.2*	*9.8*
Change (%)	*14.4*	*60.0*	*13.9*	*25.9*	*41.4*	*10.3*	*31.6*	*94.0*	*27.0*	*18.9*
Non-Operating Income	34	170	16	110	139	99	125	137	549	499
Interest	-12	7	71	98	5	4	55	67	384	131
Gross Profit	**903**	**1,359**	**1,106**	**2,165**	**1,346**	**1,415**	**1,598**	**2,391**	**5,534**	**6,750**
Less: Depreciation	297	342	290	330	328	365	370	374	1,260	1,436
PBT	**606**	**1,017**	**816**	**1,835**	**1,019**	**1,050**	**1,228**	**2,017**	**4,274**	**5,314**
Tax	271	215	250	513	262	334	280	533	1,250	1,409
Effective Tax Rate (%)	*44.8*	*21.2*	*30.7*	*28.0*	*25.7*	*31.8*	*22.8*	*26.4*	*29.2*	*26.5*
Adj. PAT (before extraordinary)	**334**	**802**	**566**	**1,322**	**756**	**716**	**948**	**1,485**	**3,024**	**3,905**
Change (%)	*-2.4*	*76.7*	*0.9*	*10.8*	*126%*	*-11%*	*67.5*	*12.3*	*18.6*	*29.1*
Extraordinary Income	334	0	0	0	0	268	0	0	334	268
Extraordinary Loss	25	52	21	21	65	31	0	0	85	95
Rep. PAT	**644**	**750**	**545**	**1,335**	**692**	**954**	**948**	**1,485**	**3,273**	**4,078**
Change (%)	*101.5*	*74.4*	*1.5*	*-6.5*	*7.5*	*27.1*	*73.9*	*11.3*	*20.6*	*24.6*

E: MOSt Estimates

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Strong volume growth of 33% YoY

ALL's vehicle sales grew 33.4% YoY in 2QFY07 to 19,869 units, in line with the strong growth witnessed by CV companies. The goods segment, which witnessed 62.7% YoY growth, spurred by the ban on overloading, ongoing infrastructure development and firm freight rates, drove the robust volume growth for ALL.

To meet the heavy demand for goods vehicles, ALL concentrated on the goods segment, leading to a decline of 21.8% in domestic passenger vehicle sales. However, once the additional demand from the overloading ban slows down, the company should once again focus on the passenger segment. State Transport Undertakings, which are large buyers of passenger vehicles, allow some flexibility in delivery schedules.

We maintain a positive view on CV sales in FY07, with sales being driven by structural drivers in the economy such as highway development and industrial growth as well as one-time demand following the ban on overloading. We believe that the impact of this one-time demand from the overloading ban will subside from 2HFY07. We expect 23.5% growth in volumes in FY07 and 12.5% growth in FY08.

STRONG GROWTH IN GOODS SEGMENT VOLUME (IN UNIT NOS)

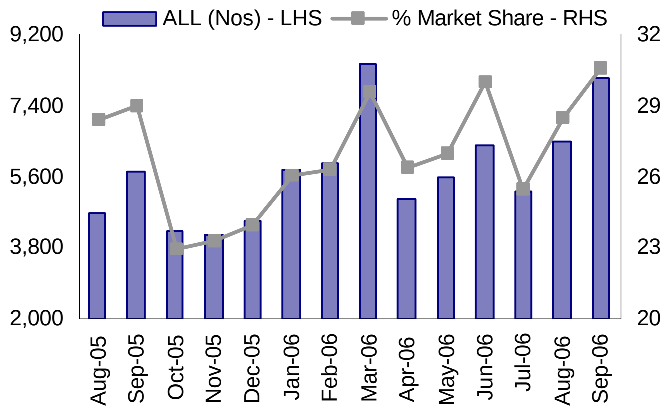
	2QFY07	2QFY06	% YOY	1QFY07	% QOQ
Passenger	3,771	4,822	-21.8	2,184	72.7
Goods	16,010	9,838	62.7	14,785	8.3
Total	**19,781**	**14,660**	**34.9**	**16,969**	**16.6**
LCV	88	235	-62.6	98	-10.2
Total	**19,869**	**14,895**	**33.4**	**17,067**	**16.4**

Source: Company/ Motilal Oswal Securities

Market share declines by 30bp

At the end of 2QFY07, Ashok Leyland's market share was 28.4%, a marginal drop of 30bp YoY. This drop in market share is more an indication of saturation of the company's installed capacities as compared to demand growth. It is also an indication of the strong performance of the other player in the HCV segment - Tata Motors. In FY07, Ashok Leyland is targeting to increase its market share by 200-250bp over its market share in FY06 to 30%.

ALL MONTHLY MARKET SHARE (%)



Source: Company/ Motilal Oswal Securities

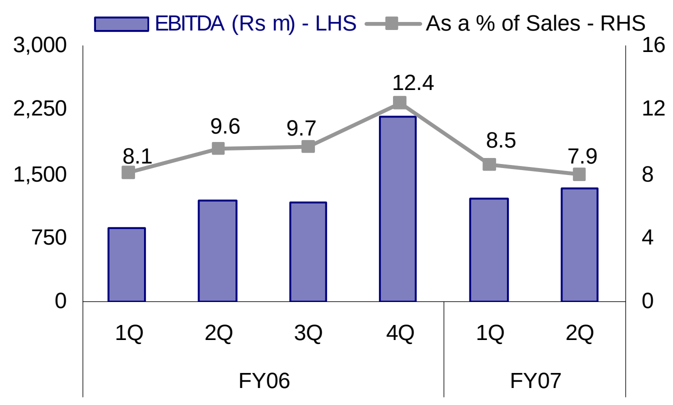
Adjusted EBITDA declines due to input cost pressures

ALL posted revenue growth of 34% YoY, ahead of volume growth of 33.4% YoY, on the back of 0.5% increase in average realization. EBITDA growth of 10.3% YoY to Rs1.3b and adjusted EBITDA margin of 7.9% are below expectations. Margins fell 170bp YoY and 60bp QoQ due to increase in raw material to sales ratio (75.6% in 2QFY07 v/s 70.7% in 2QFY06 and 73.4% in 1QFY07). Lower staff cost and other expenditure were unable to offset the higher raw material costs. Our calculation of EBITDA margins is adjusted for forex gain of Rs30.5m v/s forex loss of Rs34.2m in 2QFY06.

ALL reported 11% decline in adjusted PAT to Rs716m due to lower than expected other income. There was an extraordinary gain of Rs238m on account of sale of stake in IndusInd Bank during the quarter to comply with regulatory requirements.

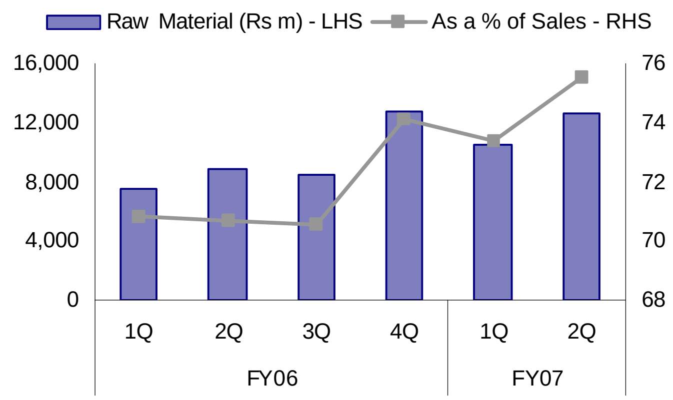
As a result of lower than expected EBITDA margin in 2QFY07, we have brought down our expectation for the full year by 110bp. We are downgrading our EBITDA margin estimate for FY07 from 10.9% to 9.8% to account for the cost pressures being faced by the company.

EBITDA MARGINS: LOWER THAN OUR EXPECTATIONS



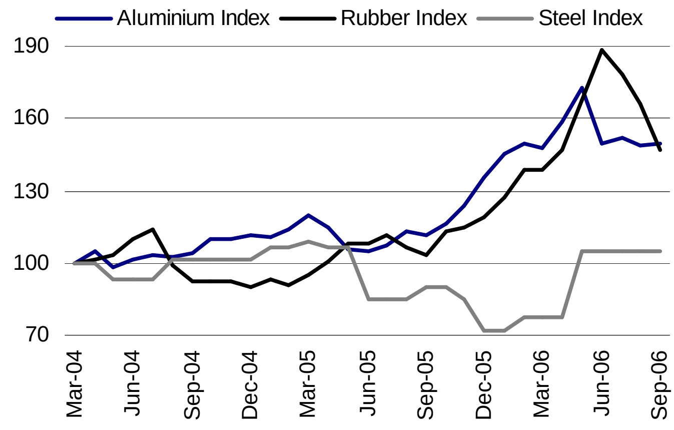
Source: Company/ Motilal Oswal Securities

RAW MATERIALS COSTS : RISING SHARPLY IN THE PAST 9 MONTHS...



Source: Company/ Motilal Oswal Securities

... DUE TO HIGHER PRICES OF KEY INPUTS (INDEX)



Source: Company/ Motilal Oswal Securities

Conference call highlights

- The acquisition of Avia's trucking business unit for US$35m will give ALL a foothold in Eastern Europe. The capacity of this unit is 20,000 units, but it is currently utilizing only 10% of its installed capacity. ALL plans to take this up to 30% over the next 2-3 years. Avia's market is mainly Europe; 55% of its sales are outside the Czech Republic.
- The funds raised from the issue of FCCBs have been fully utilized in partial payment for the Avia acquisition (as of June 2006, funds worth nearly US$20m were lying unutilized).
- ALL has announced its plans to set up a vehicle manufacturing unit in Uttaranchal at an investment of over Rs10b to create vehicle assembly and cab facility to produce 25,000 vehicles annually, scaleable to 40,000 eventually. In the initial phase, funding is to be made through internal accruals.
- The company intends to commission its Rs200m Dubai plant in the current fiscal.
- The bus segment should witness higher growth in 2HFY07, since the company was concentrating more on the goods segment in 1H.
- The management expects margins to improve in 2HFY07 based upon the second price increase during the fiscal availed of in October 2006, incremental proportion of buses in the product mix (buses have higher margins than goods vehicles), and higher sale of defense vehicles.

Outlook positive

We believe structural factors driving the CV industry are still in place. We expect ALL's volumes to grow at 17.9% CAGR over FY06-08. 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 expected improvement in EBITDA margin.

Proportion of non-cyclical revenue to increase dramatically: ALL has been making continuous efforts to broadbase its revenues by focusing on the passenger bus segment, sale of spare parts, exports and supplies to defense - all of which are non-cyclical segments. The company plans to increase the share of non-cyclicals to more than 35% of revenues over the next two years.

Operating performance to improve, going forward: ALL's efforts to effectively manage costs should yield benefits in FY07. We estimate a 40bp improvement in EBITDA margin over FY06-08. Better volumes in the coming quarters, 2.5% increase in prices of CVs availed of in October 2006 and benefits of e-sourcing will result in margin expansion.

Valuation and view

We remain positive on ALL's growth prospects. We expect volumes to grow by 23.5% in FY07, indicating residual growth rate of 17.2% for the balance of the year. We have revised our EBITDA margin assumption for FY07 to 9.8% to reflect the cost pressures being felt by the company. However, our revenue estimate has been upgraded marginally by 0.9%. As a result, our EPS estimate is lower by 10.4% for FY07 and by 6.7% for FY08. Our revised EPS estimates are now Rs3 for FY07 (earlier Rs3.3) and Rs3.5 for FY08 (earlier Rs3.7). ALL trades at 15.7x FY07E and 13.3x FY08E earnings. We maintain **Buy**.

REVISED ESTIMATES (RS M)

	FY07			FY08		
	OLD	REV.	% CHG	OLD	REV.	% CHG
Net Sales	64,567	65,119	0.9	72,695	73,322	0.9
EBITDA	7,038	6,382	(9.3)	8,142	7,772	(4.5)
Adj. PAT	4,357	3,905	(10.4)	4,918	4,594	(6.6)
Standalone EPS (Rs)	3.3	3.0	(10.4)	3.7	3.5	(6.6)

Source: Motilal Oswal Securities

Ashok Leyland: an investment profile

Company description

Ashok Leyland (ALL) is the second largest commercial vehicle manufacturer in India, with a product portfolio comprising of passenger and goods carriers across all tonnage categories. An erstwhile regionally concentrated company, ALL has made serious attempts in the last 12 months to broadbase its markets to include not only northern India but also South East Asia.

Key investment arguments

- We remain positive on the 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 to have better operating margin.
- 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 the Indian market.
- Any further increase in diesel prices will affect demand.

Recent developments

- Freight rates have increased by 20% in the past three months due to the ban on overloading.
- ALL has signed an agreement to acquire the truck business unit of Czech company AVIA for US$35m.

Valuation and view

- We expect ALL's volumes to grow at 17.9% CAGR over FY06-08.
- The company's efforts to effectively manage costs should yield benefits in FY07 and FY08.
- We estimate a 40bp improvement in EBITDA margin over FY06-08. We expect ALL to report an EPS of Rs3 in FY07 and Rs3.5 in FY08. We 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.
- We maintain a positive but cautious stance on the sector.

COMPARATIVE VALUATIONS

		ASHOK LEY	TATA MOTORS
P/E (x)	FY07E	15.7	15.1
	FY08E	13.3	13.1
EPS Gr (%)	FY07E	19.2	31.6
	FY08E	17.6	15.4
RoE (%)	FY07E	25.1	28.1
	FY08E	25.1	26.0
EV/EBITDA (x)	FY07E	8.6	9.3
	FY08E	6.8	8.1

SHAREHOLDING PATTERN (%)

	SEP.06	JUN.06	SEP.05
Promoter	39.2	39.2	50.9
Domestic Inst	19.6	20.0	23.2
Foreign	25.4	24.9	9.7
Others	15.8	15.9	16.2

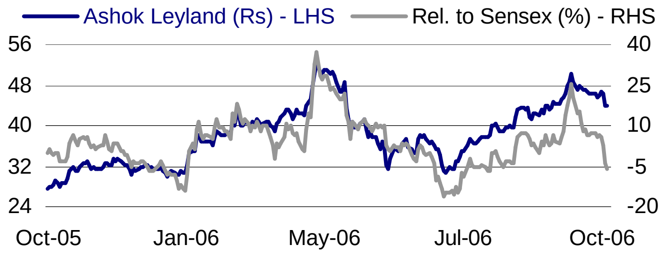
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	3.0	2.9	3.2
FY08	3.5	3.4	2.6

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
44	49	11.4	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT (Rs Million)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	**41,824**	**52,477**	**65,119**	**73,322**	**80,346**
Change (%)	*23.3*	*25.5*	*24.1*	*12.6*	*9.6*
Total Income	**41,824**	**52,477**	**65,119**	**73,322**	**80,346**
Expenditure	37,595	47,108	58,737	65,550	71,669
EBITDA	**4,228**	**5,369**	**6,382**	**7,772**	**8,677**
Change (%)	*7.2*	*27.0*	*18.9*	*21.8*	*11.6*
% of Net Sales	*10.1*	*10.2*	*9.8*	*10.6*	*10.8*
Depreciation	1,092	1,260	1,436	1,558	1,622
Interest & Finance Charge	304	384	131	194	187
Other Income	554	549	499	542	553
Non-recurring Expense	95	85	95	-	-
Non-recurring Income	260	334	268	-	-
PBT	**3,386**	**4,274**	**5,314**	**6,563**	**7,421**
Tax	836	1,250	1,409	1,969	2,301
Effective Rate (%)	*24.7*	*29.2*	*26.5*	*30.0*	*31.0*
Adj. PAT (bef. Extra)	**2,550**	**3,024**	**3,905**	**4,594**	**5,121**
% of Net Sales	*25.6*	*18.6*	*29.1*	*17.6*	*11.5*
Rep. PAT	**2,715**	**3,273**	**4,078**	**4,594**	**5,121**

BALANCE SHEET (Rs Million)

Y/E MARCH	2005	2006	2007E	2008E	2009E
Share Capital	1,189	1,222	1,324	1,324	1,324
Reserves	10,489	12,903	14,942	17,009	18,546
Net Worth	**11,679**	**14,125**	**16,266**	**18,333**	**19,869**
Loans	8,804	6,919	6,169	4,919	4,419
Deferred Tax Liability	1,708	1,797	1,797	1,797	1,797
Capital Employed	**22,191**	**22,841**	**24,232**	**25,049**	**26,085**
Gross Fixed Assets	20,023	21,385	24,199	25,249	26,249
Less: Depreciation	11,084	11,952	13,388	14,946	16,568
Net Fixed Assets	**8,938**	**9,433**	**10,811**	**10,303**	**9,681**
Investments	2,292	3,682	3,682	3,682	3,682
Curr.Assets, L & Adv	**21,573**	**22,324**	**23,958**	**26,856**	**29,862**
Inventory	5,681	9,026	9,812	11,049	12,107
Sundry Debtors	4,588	4,243	5,352	6,026	6,604
Cash & Bank Balances	7,967	6,029	8,604	9,591	10,961
Loans & Advances	3,337	3,026	190	190	190
Current Liab. & Prov.	**11,657**	**14,085**	**14,292**	**15,865**	**17,212**
Sundry Creditors	8,619	10,460	12,489	14,062	15,409
Other Liabilities	993	1,009	1,009	1,009	1,009
Provisions	2,045	2,616	794	794	794
Net Current Assets	**9,916**	**8,239**	**9,666**	**10,991**	**12,649**
Miscellaneous Exp.	193	73	73	73	73
Application of Funds	**22,191**	**22,841**	**24,232**	**25,049**	**26,085**

E: MOSt Estimates

RATIOS

Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	**1.9**	**2.5**	**3.0**	**3.5**	**3.9**
Cash EPS	3.1	3.5	4.0	4.6	5.1
EPS Growth (%)	17.2	29.7	19.2	17.6	11.5
Book Value per Share	9.8	11.6	12.3	13.9	15.0
DPS	1.0	1.3	1.7	2.1	2.9
Payout (Incl. Div. Tax) %	48.7	48.8	50.0	55.0	70.0
Valuation (x)					
P/E		18.7	15.7	13.3	11.9
Cash P/E		13.2	11.4	9.9	9.1
EV/EBITDA		10.0	8.6	6.8	5.9
EV/Sales		1.0	0.8	0.7	0.6
Price to Book Value		4.0	3.8	3.3	3.1
Dividend Yield (%)		2.8	3.6	4.5	6.4
Profitability Ratios (%)					
RoE	23.2	23.2	25.1	25.1	25.8
RoCE	16.6	20.4	22.5	27.0	29.2
Leverage Ratio					
Debt/Equity (x)	0.8	0.5	0.4	0.3	0.2

CASH FLOW STATEMENT (Rs Million)

Y/E MARCH	2005	2006	2007E	2008E	2009E
OP/(Loss) before Tax	3,136	4,109	4,946	6,215	7,055
Depreciation & Amortisat	1,092	1,260	1,436	1,558	1,622
Direct Taxes Paid	-930	-1,161	-1,409	-1,969	-2,301
(Inc)/Dec in Working Capi	1,241	-141	1,213	-337	-289
Other Items	-365	738	173	0	0
CF from Oper. Activi	**4,174**	**4,805**	**6,358**	**5,466**	**6,088**
Extra-ordinary Items	165	249	173	0	0
CF after EO Items	**4,339**	**5,054**	**6,531**	**5,466**	**6,088**
(Inc)/Dec in FA+CWIP	-1,671	-2,317	-1,400	-1,050	-1,000
(Pur)/Sale of Invest.	-826	-1,390	0	0	0
CF from Inv. Activity	**-2,497**	**-3,707**	**-1,400**	**-1,050**	**-1,000**
Issue of Shares	0	32	102	0	0
Inc/(Dec) in Debt	3,815	-1,885	-750	-1,250	-500
Interest Rec./(Paid)	250	165	369	348	366
Dividends Paid	-1,189	-1,598	-2,039	-2,527	-3,585
CF from Fin. Activity	**2,875**	**-3,285**	**-2,318**	**-3,428**	**-3,718**
Inc/(Dec) in Cash	**4,717**	**-1,938**	**2,813**	**988**	**1,370**
Add: Beginning Balance	3,250	7,967	6,029	8,604	9,591
Closing Balance	**7,967**	**6,029**	**8,842**	**9,591**	**10,961**

NOTES

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Disclosure of Interest Statement	Ashok Leyland
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