27 July 2009 | 11 pages

Ashok Leyland (ASOK.BO)

Equity ☑
Target price change ☑
Estimate change ☑

Sell: 1QFY10 Results – Operationally a Weak Quarter

- **Recurring PAT at Rs 88m exceeds estimates** — of Rs 40m. But we note this was buoyed by a tax write-back (Rs53m) & non op. income. Operationally, EBITDA was 86% below forecasts. Sales were ~8% above estimates due to higher realizations (we believe on account of spare parts & engine sales).
- **Inventory liquidation?** — EBITDA margins at 1.3% (-670 bps y/y, -610 bps q/q) were 930 bps below our forecasts. While we expected material cost savings to aid profitability this Q, material costs/vehicle increased by 5% q/q. We think this was due to liquidation of high cost inventory. As at end of 4Q, the company had almost 6500 units in the pipeline. Staff costs also rose 16% q/q, which is surprising given 29% fall in volumes sequentially. Other expenses/vehicle have also increased by 10% q/q.
- **AL affected by regional concentration** — AL continues to be adversely affected, given concentration of sales in southern India (coupled with loss of market share in the north and eastern markets). Mgmt had also indicated in the recent analyst meet that its sales were affected by consumers shifting to haulage vehicles, rather than speciality vehicles like tractor trailers, tippers.
- **Outlook remains modest** — Mgmt. guided to single-digit domestic volume growth in FY10 and expects exports to increase to 9,000 units. It also expects to increase its operating margins by 350 bps y/y in FY10.
- **Sell; revise TP to Rs 28**— (From Rs 29 earlier) as we reduce earnings 2-7% over FY10-FY11E. We have marginally adjusted EBITDA margins downwards as we expect some material cost increases in 2HFY10. Also introduce FY12 estimates.

Sell/Medium Risk	3M
Price (27 Jul 09)	Rs34.95
Target price	Rs28.00
from Rs29.00	
Expected share price return	-19.9%
Expected dividend yield	3.1%
Expected total return	**-16.7%**
Market Cap	Rs46,495M
	US$967M

Price Performance (RIC: ASOK.BO, BB: AL IN)

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2008A	4,787	3.60	4.0	9.7	2.2	23.7	4.3
2009A	1,900	1.43	-60.3	24.5	1.3	6.8	2.9
2010E	2,071	1.56	9.0	22.5	1.3	5.9	3.1
2011E	2,830	2.13	36.6	16.4	1.3	7.9	3.7
2012E	3,174	2.39	12.2	14.7	1.2	8.4	0.0

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

Fiscal year end 31-Mar	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	9.7	24.5	22.5	16.4	14.7
EV/EBITDA adjusted (x)	5.7	12.0	11.2	8.6	7.7
P/BV (x)	2.2	1.3	1.3	1.3	1.2
Dividend yield (%)	4.3	2.9	3.1	3.7	0.0
Per Share Data (Rs)					
EPS adjusted	3.60	1.43	1.56	2.13	2.39
EPS reported	3.53	1.43	1.56	2.13	2.39
BVPS	16.15	26.11	26.64	27.25	29.63
DPS	1.50	1.00	1.10	1.30	0.00
Profit & Loss (RsM)					
Net sales	77,291	59,586	61,427	73,076	85,402
Operating expenses	-71,025	-56,901	-57,973	-68,099	-79,592
EBIT	**6,266**	**2,685**	**3,454**	**4,976**	**5,810**
Net interest expense	-763	-1,603	-1,608	-1,952	-2,284
Non-operating/exceptionals	878	1,003	742	512	705
Pre-tax profit	**6,382**	**2,084**	**2,589**	**3,537**	**4,232**
Tax	-1,688	-185	-518	-707	-1,058
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**4,693**	**1,900**	**2,071**	**2,830**	**3,174**
Adjusted earnings	4,787	1,900	2,071	2,830	3,174
Adjusted EBITDA	8,040	4,469	5,591	7,308	8,392
Growth Rates (%)					
Sales	7.8	-22.9	3.1	19.0	16.9
EBIT adjusted	13.5	-57.2	28.7	44.1	16.8
EBITDA adjusted	14.4	-44.4	25.1	30.7	14.8
EPS adjusted	4.0	-60.3	9.0	36.6	12.2
Cash Flow (RsM)					
Operating cash flow	**8,876**	**-898**	**4,208**	**5,161**	**5,755**
Depreciation/amortization	1,774	1,784	2,137	2,331	2,581
Net working capital	1,403	-6,175	0	0	0
Investing cash flow	**-6,672**	**-24,895**	**-6,684**	**-6,183**	**-6,182**
Capital expenditure	-6,876	-25,210	-7,000	-6,500	-6,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**328**	**9,150**	**1,026**	**2,159**	**5,225**
Borrowings	2,471	10,706	1,026	2,159	5,225
Dividends paid	-2,337	-1,556	0	0	0
Change in cash	**2,532**	**-16,643**	**-1,451**	**1,136**	**4,798**
Balance Sheet (RsM)					
Total assets	**55,622**	**78,363**	**78,170**	**82,564**	**90,859**
Cash & cash equivalent	4,514	881	471	717	500
Accounts receivable	3,758	9,580	6,545	5,561	6,507
Net fixed assets	20,548	43,974	48,837	53,006	56,924
Total liabilities	**34,133**	**43,585**	**42,728**	**46,318**	**51,440**
Accounts payable	17,351	17,713	15,114	15,839	17,386
Total Debt	8,875	19,581	20,607	22,766	27,991
Shareholders' funds	**21,490**	**34,739**	**35,441**	**36,245**	**39,419**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	10.4	7.5	9.1	10.0	9.8
ROE adjusted	23.7	6.8	5.9	7.9	8.4
ROIC adjusted	21.3	6.6	5.4	7.8	8.1
Net debt to equity	20.3	53.8	56.8	60.8	69.7
Total debt to capital	29.2	36.0	36.8	38.6	41.5

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1QFY10 Results – Operationally Very Weak Quarter

Figure 1. Ashok Leyland – 1QFY10 Operational Results

	1QFY09	1QFY10	% chg YoY	CIRA Comments
Volumes (Nos.)				
H / MHCVs	18,180	7,467	(58.9)	Driven by 63% YoY decline in goods sales and 47% YoY decline in passenger sales
LCVs	245	231	(5.7)	
Total CVs	**18,425**	**7,698**	**(58.2)**	
Product mix (%)				
H / MHCVs	98.7	97.0		
LCVs	1.3	3.0		

Source: Citi Investment Research and Analysis, SIAM

Figure 2. Ashok Leyland – 1QFY10 Financial Results

	1QFY09	1QFY10	% chg YoY	CIRA Comments
Net sales	18,839	9,125	(51.6)	8% above estimates due to higher than expected spare parts and engine sales
Decrease/(Increase) in Stocks	-	374		
Raw Materials	14,376	6,252	(56.5)	Higher than forecasts as raw material benefit expected to come in this Q did not materialise
Staff costs	1,626	1,441	(11.4)	Decline attributed to reduction in temporary employees; salary cuts but staff costs increased q/q
Other Expenses	1,326	935	(29.5)	
Total Expenditure	17,328	9,003	(48.0)	
EBITDA	**1,511**	**122**	**(91.9)**	**86% below forecasts**
Foreign Exchange Gain / Loss	(339)	-		
Interest	107	258	141.3	Declined q/q due to reduction in working capital requirements
Other income	122	606	398.3	Significantly higher than expectations
EBDT	1,186	470	(60.4)	
Depreciation & Amortization	441	435	(1.4)	
PBT	745	35	(95.3)	
Exceptional income	-	-		
Exceptional expenditure	(22)	(10)		Related to VRS expense
Tax	218	(53)		Tax Write Back
PAT	506	78	(84.6)	
PAT (pre exceptionals)	**765**	**88**	**(88.5)**	**Better than expectations due to tax write back, operationally results were very weak**
Profit Margins (%)				
EBITDA (%) net sales	8.0	1.3		670 bps decline Y/Y, -610 bps q/q, 930 bps below forecasts
Tax / PBT (%)	30.1	-217.1		Tax write Back
Net profit margins (%) Net Sales	4.1	1.0		
Cost ratios (%)				
Raw materials / sales	76.3	72.6		440 bps above estimates
Staff costs / sales	8.6	15.8		340 bps above estimates
Other expenses / sales	7.0	10.2		130 bps above estimates

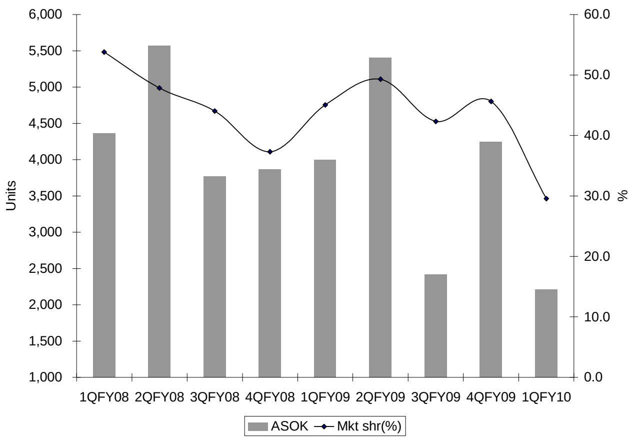
Source: Company

Business Analysis

Key Points:

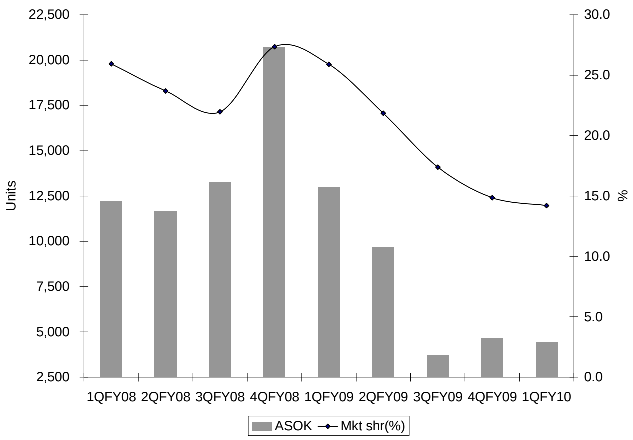
1) Domestic Industry: ALL cedes market share in truck segment – In FY09, truck sales declined 37% y/y while the bus industry declined 10% y/y. Ashok Leyland maintained its leadership position in buses, gaining 70 bps market share, but ceded 380 bps market share in the truck segment. This was on account of 1) a contraction in the southern market in which ALL is the dominant player, and loss of market share in North and Eastern regions (see Figure 6), 2) significant decline of the heavier tonnage trucks, which is a key segment for Ashok Leyland (67% of the total volumes of Ashok Leyland comes from >16T segment) and 3) truck operators preferred haulage vehicles over the speciality vehicles like tractor trailers, tippers and multi activity vehicles, which affected Ashok Leyland's sales.

Figure 3. Ashok Leyland Domestic Bus Volumes and Market share (%) Trend



Source: SIAM

Figure 4. Ashok Leyland Domestic Truck Volumes and Market share (%) Trend



Source: SIAM

Ashok Leyland ceded market share in the 16-25 MT segment and the tractor trailer segment, which forms around 43% and 6% of total domestic truck industry volumes

Figure 5. MHCV Domestic -Trucks Segmental Market Share (%)

	FY08	FY09	YoY Chg (%)
7.5-12 MT			
ASOK	1,774	1,271	(28.4)
Industry	41,038	27,497	(33.0)
Mkt shr (%)	4.3	4.6	+30 bps
12-16.2 MT			
ASOK	12,468	9,042	(27.5)
Industry	60,456	42,541	(29.6)
Mkt shr (%)	20.6	21.3	-70 bps
16.2-25 MT			
ASOK	35,633	16,444	(53.9)
Industry	106,385	63,928	(39.9)
Mkt shr (%)	33.5	25.7	-780 bps
>25 MT			
ASOK	-	1,353	
Industry	1,054	3,746	255.4
Mkt shr (%)	-	36.1	
Tractor Trailers			
ASOK	7,971	2,915	(63.4)
Industry	23,438	9,416	(59.8)
Mkt shr (%)	34.0	31.0	-300 bps

Source: SIAM

Eastern market performed much better than the South and North market. Ashok Leyland lost significant market share in Northern region and Eastern region to Tata Motors while it increased market share in the South region

Figure 6. MHCV Trucks – Regional Market Shares (%)

	FY07	FY08	FY09
South Mkt	77,023	87,956	51,437
ASOK mkt shr (%)	48.0	50.0	53.0
Share of Total Mkt (%)	31.3	37.9	35.0
East Mkt	33,668	34,585	33,601
ASOK mkt shr (%)	24.0	11.0	9.0
Share of Total Mkt (%)	13.7	14.9	22.8
North and West Mkt	135,708	109,830	62,090
ASOK mkt shr (%)	14.8	9.2	1.2
Share of Total Mkt (%)	55.1	47.3	42.2

Source: Citi Investment Research and Analysis, Company

Exports improved though…- Export volumes declined by only 7% y/y as Ashok Leyland's sales come from developing countries and are not leveraged to developed economies, which faced severe recessionary conditions. Strong growth in Latin America, Bangladesh and Maldives offset the sharp decline in Sri Lanka (due to civil unrest) and Middle East.

Figure 7. Export Performance

Countries	FY08	FY09	YoY Chg (%)
Sri Lanka	2,353	1,076	(54.3)
Middle East	3,015	2,523	(16.3)
Latin America	608	1,533	152.1
Bangladesh, Maldives	1,043	1,491	43.0
Others	266	189	(28.9)
Total	**7,285**	**6,812**	**(6.5)**

Source: Company

2) Capacities / Product planned: Capacity utilization fell sharply to 52% in FY09 from nearly 100% in FY08 due to a sharp fall in volumes. We expect capacity utilization levels to fall further to 36% in FY10 as another 50,000 unit capacity will be added at the Uttarakhand plant. The company invested Rs9.7 bn mainly for addition in capacity in the Uttarakhand plant, manufacture of H series and Neptune engines. The company has indicated that it would continue to invest in product development and some of the new products planned are as follows:

1. **New Unitruck platform** which will be used across 16-49 ton trucks by April 2010 for both domestic and export markets
2. **New Neptune engines:** 4 and 6 cylinder family of inline engines ranging from 160-230 hp in 4 cylinder engines and 270-380 hp in 6 cylinder engines
3. **New products in the truck segment:** 3116 haulage truck, 3518 tractor trailer, 4019 haulage truck (to be launched by 2QFY10) and 2521 tipper (to be launched by 2QFY10)
4. **Two new CNG buses** will also be launched

3) Future Outlook and Fund Raising Plans: In the recent analyst meet, management noted the following:

1. Management guided to a single digit domestic volume growth in FY10 and expects exports to increase to 9000 units as Sri Lanka market recovers
2. Management also expects to increase its operating margins by 350 bps y/y in FY10 driven by material cost benefits (already taken a material cost decline of Rs 25,000 in March09), 2% price increase taken in July, 20% voluntary cut in employee pay and control on other expenses.
3. Management also plans to conserve cash by reducing inventories to <4,000 units by Sep09, reduce working capital by Rs 5bn from March09 levels and reduce factory inventory by Rs 2 bn by Sep09.
4. Management also indicated that it has passed a board resolution to raise funds for its capex plans but did not state clearly what would be the mix of debt/equity for raising funds.

We await more details in tomorrow's conference call to determine if management is on track to meet its targets, especially on inventory reduction.

Ashok Leyland

Company description

ALL is owned by the Hinduja Group (which has an equity stake of 50.9%). ALL is the second-largest CV manufacturer in India, with a strong focus on medium and heavy commercial vehicles (MHCVs). The company's core product portfolio comprises MHCVs (goods vehicles and buses), and it also manufactures a range of vehicles suited for defense and special applications. Its recent successes in the export market are indicative of its product quality. Sales of spares and engines add to revenue and earnings, especially during cyclical downturns.

Investment strategy

We maintain our Sell, Medium Risk rating. Growth prospects for ALL are improving, albeit slowly. Over the near term, economic growth is expected to continue to decelerate, and with a slowdown in the investment cycle, demand for commercial vehicles is expected to remain weak. With its focus on medium and heavy trucks, ALL is more vulnerable than its peer Tata Motors to a deceleration in CV sales. Over the long term, the outlook for CV sales remains healthy, key reasons being a sustained pickup in economic activity from FY11E, a focus on infrastructure spending and a strong replacement cycle (15% of the existing fleet in India is more than 15 years old and needs to be replaced both for commercial and environmental reasons). Moreover, growth in the agriculture, infrastructure and manufacturing sectors - all of which have positive linkages to the freight business - should remain positive over the long term. However, in the near to medium term we expect Ashok Leyland sales to be under pressure due to the challenging economic environment.

Valuation

Our price target of Rs28 for ALL is based on an 8x P/CEPS on Sep10e CEPS. We revert to our cash earnings based methodology as we expect earnings volatility to reduce into 2HFY10/ early FY11e as the CV cycle gradually improves. We now base our target price at 8x on Sep10e CEPS (in line with historical average of 8.4x). At present, the stock is trading at 20x P/E on FY10 EPS – which is a 20% premium to its historical average. We believe the stock is expensive at these valuations.

Risks

We rate ALL Medium Risk, lower than the High risk assigned by our quantitative risk-rating system, which tracks 260-day historical share-price volatility. We rate ALL Medium Risk, in line with its other peers - both in India - and also globally. The key risk factors to our target price are movements in economic variables - particularly GDP growth, interest rates and fuel prices, to which sales of commercial vehicles are very sensitive. Input costs are volatile and linked to global commodity prices for metals, plastics, etc. The profitability and viability of the STUs over the long term are an important risk factor, given that the STUs are the largest buyers of ALL buses. Key upside risks to our target price include: 1) Greater-than-expected volume growth on account of the Supreme Court ruling on overloading; 2) Significant reduction in input costs (notably steel and aluminium) would benefit earnings; and 3) Effective integration of the Avia acquisition could enable ALL to penetrate the domestic LCV market successfully..

Appendix A-1

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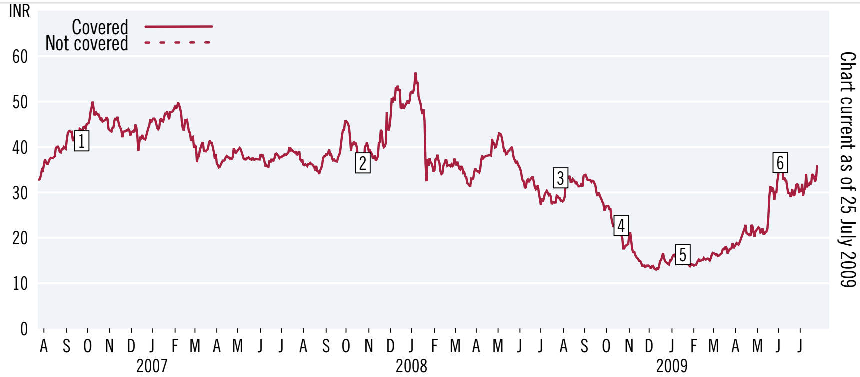
Ashok Leyland (ASOK.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy



	Date	Rating	Target Price	Closing Price
1	22-Sep-06	3L	*39.00	43.30
2	24-Oct-07	3L	*38.00	37.15
3	29-Jul-08	3L	*26.00	28.20
4	22-Oct-08	*3M	*19.00	20.60
5	16-Jan-09	3M	*12.00	15.00
6	3-Jun-09	3M	*29.00	36.30

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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