



Ashok Leyland

STOCK INFO.	BLOOMBERG
BSE Sensex: 14,091	AL IN
	REUTERS CODE
S&P CNX: 4,083	ASOK.BO

31 January 2007

Buy

Previous Recommendation: Buy

Rs48

Equity Shares (m)	1,323.7
52-Week Range	54/30
1,6,12 Rel. Perf. (%)	3/7/16
M.Cap. (Rs b)	64.0
M.Cap. (US\$ b)	1.4

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
3/06A	52,477	3,024	2.5	29.7	19.5	4.2	23.2	20.4	1.1	10.5
3/07E	68,722	4,126	3.1	25.9	15.5	3.9	25.9	24.3	0.8	8.5
3/08E	77,810	4,982	3.8	20.7	12.8	3.4	26.8	28.4	0.7	6.8

- Ashok Leyland's (ALL) sales, adjusted EBITDA and adjusted PAT for 3QFY07 grew by 47.8%, 61% and 96.5% YoY, respectively (v/s our estimate of 41.6%, 43.7% and 70.9% growth, respectively).
- Revenue growth of 47.8% YoY to Rs17.8b was driven by volume growth of 53.9% YoY, although realizations declined 3.95% YoY. Adj. EBITDA margins improved to 10.5%, an increase of 260bp QoQ, while EBITDA was Rs1.9b (adj. for forex loss of Rs28m).
- Margin improvement was achieved despite rising input cost pressures. According to the management, volume expansion and the resultant operating economies helped improve the performance.
- ALL reported 96.5% growth in adjusted PAT to Rs1.11b due to lower than expected interest cost and depreciation.
- Due to higher CV demand from the goods segment, the company focused most of its production activities in that direction, resulting in lower bus production.
- Ashok Leyland has established Ashok Leyland (UAE) LLC, a subsidiary in Ras Al Khaimah, UAE, for setting up a bus body assembly plant to cater to the Middle East and neighboring markets.
- Given the strong volume growth momentum, we have revised upwards our volume estimates by 1.6%, while our EBITDA margin estimate has been revised upwards by 20bp for FY07. The stock trades at 15.5x FY07E revised EPS of Rs3.1 and 12.8x FY08E revised EPS of Rs3.8. We maintain **Buy**.

QUARTERLY PERFORMANCE

(RS MILLION)

	FY 06				FY 07				FY 06	FY 07E
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4QE		
Total Volumes (nos)	13,320	14,895	13,038	20,373	17,067	19,869	20,068	22,802	61,626	79,806
Net Sales	10,632	12,501	12,024	17,319	14,239	16,757	17,776	19,950	52,477	68,722
Change (%)	29.5	36.7	21.8	18.7	33.9	34.0	47.8	15.2	25.5	31.0
Total Cost	9,774	11,304	10,863	15,166	13,026	15,437	15,907	17,493	47,108	61,864
EBITDA	858	1,197	1,161	2,153	1,213	1,320	1,869	2,457	5,369	6,858
As a % of Sales	8.1	9.6	9.7	12.4	8.5	7.9	10.5	12.3	10.2	10.0
Change (%)	14.4	60.0	13.9	25.9	41.4	10.3	61.0	14.1	27.0	27.8
Non-Operating Income	34	170	16	110	139	99	64	108	549	409
Interest	-12	7	71	98	5	4	26	37	384	72
Gross Profit	903	1,359	1,106	2,165	1,346	1,415	1,907	2,528	5,534	7,195
Less: Depreciation	297	342	290	330	328	365	332	343	1,260	1,368
PBT	606	1,017	816	1,835	1,019	1,050	1,574	2,185	4,274	5,828
Tax	271	215	250	513	262	334	463	643	1,250	1,702
Effective Tax Rate (%)	44.8	21.2	30.7	28.0	25.7	31.8	29.4	29.4	29.2	29.2
Adj. PAT (before extraordinary)	334	802	566	1,322	756	716	1,112	1,542	3,024	4,126
Change (%)	-2.4	76.7	0.9	10.8	126.1	-10.7	96.5	16.6	18.6	36.4
Extraordinary Income	334	0	0	0	0	268	0	0	334	268
Extraordinary Loss	25	52	21	21	65	31	59	0	85	155
Rep. PAT	644	750	545	1,335	692	954	1,053	1,542	3,273	4,240
Change (%)	101.5	74.4	1.5	-6.5	7.5	27.1	93.1	15.5	20.6	29.5

E: MOST Estimates

Volumes: strong growth of 33% YoY

In line with the strong growth witnessed by CV companies in 3QFY07, Ashok Leyland has grown its volumes by 5.9% YoY to 20,068 units. Growth has been driven by the goods segment, which witnessed 80.9% YoY growth, spurred by the ban on overloading, ongoing infrastructure development and firm freight rates.

Due to the heavy demand from the goods segment, Ashok Leyland concentrated its production more towards this segment, leading to decline of 80% in domestic passenger vehicle sales. However, once the additional demand from the overloading ban slows down, the company can focus on passenger segment. This demand mainly arises from STU orders, where there is some flexibility in delivery schedules.

We maintain a positive view on CV sales in FY07, with sales being driven by the structural drivers in the economy such as highway development and industrial growth, as well as one time demand from the ban on overloading. We expect 29.5% growth in volumes in FY07 and 12.5% growth in FY08.

VOLUMES: STRONG GROWTH IN GOODS SEGMENT (IN UNIT NOS)

	3QFY07	3QFY06	% YOY	2QFY07	% QOQ
Passenger	4,452	4,203	5.9	3,771	18.1
Goods	15,545	8,591	80.9	16,010	-2.9
Total	19,997	12,794	56.3	19,781	1.1
LCV	71	244	-70.9	88	-19.3
Total	20,068	13,038	53.9	19,869	1.0

Source: Company/Motilal Oswal Securities

Market share gains in M&HCVs

Ashok Leyland’s market share in M&HCV domestic goods segment increased to 25.9% in 9MFY07 from 22.6% in 9MFY06. However, this was at the expense of its position in passenger carrier segment. Its share in the M&HCV domestic passenger carrier segment declined from 53.1% in 9MFY06 to 39% in 9MFY07. This drop is more an indication of saturation of the company’s installed capacities as compared to the demand growth. Moreover, due to higher CV demand from the goods segment, the company focused most of its production activities in that direction, resulting in lower bus production.

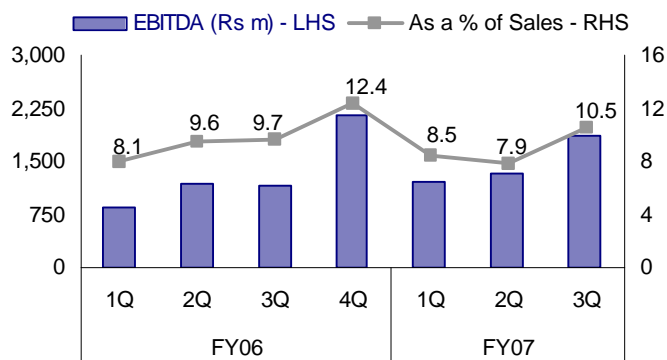
Adjusted EBITDA higher due to operating efficiencies

Ashok Leyland posted revenue growth of 47.8% YoY to Rs17.8b, driven by volume growth of 53.9% YoY, although realizations declined 3.95% YoY. Adj. EBITDA margins improved to 10.5%, an increase of 260bp QoQ, while EBITDA was Rs1.9b (adj. for forex loss of Rs28m). Margin improvement was achieved despite rising input cost pressures. According to the management, volume expansion and the resultant operating economies helped improve the performance.

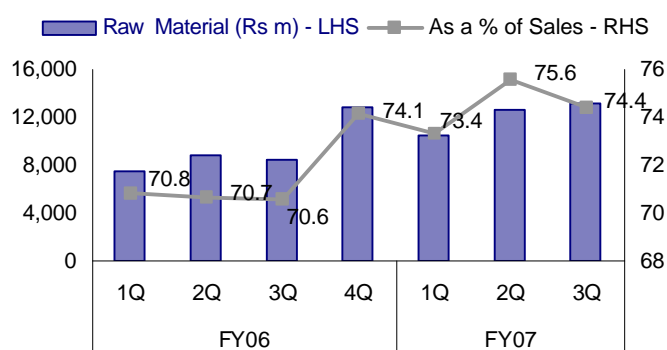
Ashok Leyland reported 96.5% growth in adjusted PAT to Rs1.11b due to lower than expected interest cost and depreciation.

As a result of the strong improvement in EBITDA margins and the volume-led operating efficiencies, we are upgrading our EBITDA margin expectation for FY07 by 20bp. Our revised EBITDA margin expectation for FY07 is 10%.

EBITDA MARGINS EXCEED EXPECTATIONS



RAW MATERIALS COSTS INCREASE ON A YOY BASIS



Source: Company/Motilal Oswal Securities

Investment argument

We believe structural factors for the CV industry are still in place. We expect Ashok Leyland's volumes to grow at 20.7% CAGR over FY06-08. Its focus on non-cyclical business segments such as passenger vehicles and aggregate exports is expected to cushion domestic business cyclicity. The quality of earnings and earnings momentum 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: Ashok Leyland has been making continuous efforts to broad base 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:

The company's efforts to effectively manage costs should yield benefits in FY07. We estimate a 80bp improvement in EBITDA margin over FY07-09. Better volumes in the coming quarters, 2.5% increase in prices of CVs availed in October 2006 and benefits of e-sourcing will result in margin expansion.

Valuation and view

We remain positive on Ashok Leyland's growth prospects. We expect volumes to grow by 29.5% in FY07, indicating residual growth rate of 11.9% for the balance of the year. Given the strong volume growth momentum, we have revised upwards our volume estimates by 1.6%, while our EBITDA margin estimate has been revised upwards by 20bp for FY07. The stock trades at 15.5x FY07E revised EPS of Rs3.1 and 12.8x FY08E revised EPS of Rs3.8. We maintain **Buy** with a target price of Rs53.

Ashok Leyland: an investment profile

Company description

Ashok Leyland 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 CV company, Ashok Leyland has made serious attempts in the last 12 months to broad base 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.

COMPARATIVE VALUATIONS

		ASHOK LEY	TATA MOTORS
P/E (x)	FY07E	15.5	15.6
	FY08E	12.8	13.6
EPS Gr (%)	FY07E	25.9	34.8
	FY08E	20.7	14.6
RoE (%)	FY07E	25.9	29.1
	FY08E	26.8	26.7
EV/EBITDA (x)	FY07E	8.5	9.8
	FY08E	6.8	8.5

SHAREHOLDING PATTERN (%)

	DEC.06	SEP.06	DEC.05
Promoter	55.0	55.0	55.0
Domestic Inst	8.8	9.0	8.3
Foreign	26.2	25.9	26.8
Others	10.1	10.1	9.9

Recent developments

- ✍ Freight rates have maintained their upward trend following the ban on overloading last year.
- ✍ ALL has signed an agreement to acquire the truck business unit of Czech company AVIA for \$35m.

Valuation and view

- ✍ We expect ALL's volumes to grow at 20.7% CAGR over FY06-08E
- ✍ Ashok Leyland's efforts to effectively manage costs should yield benefits in FY07 and FY08. We estimate a 80bp improvement in EBITDA margin over FY07E-09E. We estimate ALL to report an EPS of Rs3.1 in FY07E and Rs3.8 in FY08E. We maintain **Buy**.

Sector view

- ✍ Demand related factor of IIP production remain strong for the sector.
- ✍ Freight rates have remained firm quelling any near term fears.
- ✍ We maintain a positive but cautious stance on the sector

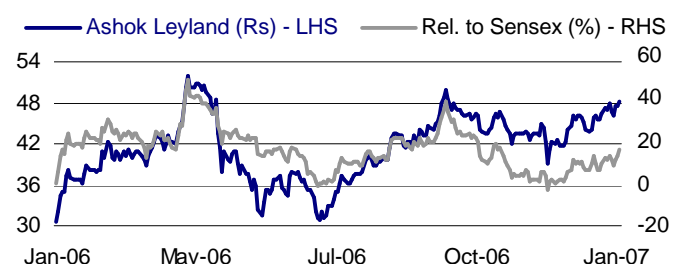
EPS: MOST FORECAST VS CONSENSUS (RS)

	MOST FORECAST	CONSENSUS FORECAST	VARIATION (%)
FY07	3.1	2.8	9.0
FY08	3.8	3.4	11.0

TARGET PRICE AND RECOMMENDATION

CURRENT PRICE (RS)	TARGET PRICE (RS)	UPSIDE (%)	RECO.
48	53	9.6	Buy

STOCK PERFORMANCE (1 YEAR)



INCOME STATEMENT					
(Rs Million)					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Net Sales	41,824	52,477	68,722	77,810	85,563
Change (%)	23.3	25.5	31.0	13.2	10.0
Total Income	41,824	52,477	68,722	77,810	85,563
Expenditure	37,595	47,108	61,864	69,601	76,365
EBITDA	4,228	5,369	6,858	8,209	9,198
Change (%)	7.2	27.0	27.8	19.7	12.0
% of Net Sales	10.1	10.2	10.0	10.6	10.8
Depreciation	1,092	1,260	1,368	1,483	1,545
Interest & Finance Charge	304	384	72	61	51
Other Income	554	549	409	452	484
Non-recurring Expense	95	85	155	-	-
Non-recurring Income	260	334	268	-	-
PBT	3,386	4,274	5,828	7,117	8,085
Tax	836	1,250	1,702	2,135	2,426
Effective Rate (%)	24.7	29.2	29.2	30.0	30.0
Adj. PAT (bef. Extra)	2,550	3,024	4,126	4,982	5,660
% of Net Sales	25.6	18.6	36.4	20.7	13.6
Rep. PAT	2,715	3,273	4,240	4,982	5,660

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	15,023	17,265	18,963
Net Worth	11,679	14,125	16,347	18,588	20,286
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	24,313	25,304	26,502
Gross Fixed Assets	20,023	21,385	24,199	25,249	26,249
Less: Depreciation	11,084	11,952	13,320	14,803	16,348
Net Fixed Assets	8,938	9,433	10,879	10,446	9,901
Investments	2,292	3,682	3,682	3,682	3,682
Curr. Assets, L & Adv	21,573	22,324	24,662	27,830	31,060
Inventory	5,681	9,026	10,355	11,725	12,893
Sundry Debtors	4,588	4,243	5,648	6,395	7,033
Cash & Bank Balances	7,967	6,029	8,468	9,520	10,944
Loans & Advances	3,337	3,026	190	190	190
Current Liab. & Prov.	11,657	14,085	14,983	16,726	18,213
Sundry Creditors	8,619	10,460	13,180	14,922	16,409
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	9,678	11,104	12,847
Miscellaneous Exp.	193	73	73	73	73
Application of Funds	22,191	22,841	24,313	25,304	26,502

E: Most Estimates

RATIOS					
Y/E MARCH	2005	2006	2007E	2008E	2009E
Basic (Rs)					
EPS	1.9	2.5	3.1	3.8	4.3
Cash EPS	3.1	3.5	4.2	4.9	5.4
EPS Growth (%)	17.2	29.7	25.9	20.7	13.6
Book Value per Share	9.8	11.6	12.3	14.0	15.3
DPS	1.0	1.3	1.7	2.2	3.2
Payout (Incl. Div. Tax) %	48.7	48.8	50.0	55.0	70.0
Valuation (x)					
P/E		19.5	15.5	12.8	11.3
Cash P/E		13.8	11.7	9.9	8.9
EV/EBITDA		10.5	8.5	6.8	5.8
EV/Sales		1.1	0.8	0.7	0.6
Price to Book Value		4.2	3.9	3.4	3.2
Dividend Yield (%)		2.7	3.6	4.6	6.7
Profitability Ratios (%)					
RoE	23.2	23.2	25.9	26.8	27.9
RoCE	16.6	20.4	24.3	28.4	30.7
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	5,491	6,725	7,653
Depreciation & Amortisat	1,092	1,260	1,368	1,483	1,545
Direct Taxes Paid	-930	-1,161	-1,702	-2,135	-2,426
(Inc)/Dec in Working Capi	1,241	-141	1,065	-373	-319
Other Items	-365	738	114	0	0
CF from Oper. Activi	4,174	4,805	6,335	5,700	6,454
Extra-ordinary Items	165	249	114	0	0
CF after EO Items	4,339	5,054	6,449	5,700	6,454
(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	337	391	432
Dividends Paid	-1,189	-1,598	-2,120	-2,740	-3,962
CF from Fin. Activity	2,875	-3,285	-2,431	-3,599	-4,029
Inc/(Dec) in Cash	4,717	-1,938	2,618	1,052	1,424
Add: Beginning Balance	3,250	7,967	6,029	8,468	9,520
Closing Balance	7,967	6,029	8,647	9,520	10,944



For more copies or other information, contact

Institutional: Navin Agarwal. **Retail:** Manish Shah, Mihir Kothari

Phone: (91-22) 39825500 Fax: (91-22) 22885038. E-mail: inquire@motiloswal.com

Motilal Oswal Securities Ltd, 3rd Floor, Hoechst House, Nariman Point, Mumbai 400 021

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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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