Company

29 July 2010 | 11 pages

Ashok Leyland (ASOK.BO)

Maintain Sell: 1QFY11 Results Disappoint

Equity ☑
Target price change ☑
Estimate change ☑

- **Recurring PAT of Rs1.2bn marginally below our estimates...** — ...and 22% below consensus. ASPs disappointed, declining Q/Q. Ashok Leyland (ALL) mgmt noted this was partially attributable to a) lower sales of defense kits and b) lower engine sales. The commissioning of the new plant resulted in higher operating (wages/SGA were 22% ahead of our estimates) expenses. Interest costs were ~50% above estimates as these are not capitalized post commissioning. The effective tax rate continues to baffle – it was 17% vs. expectations of 23% – mgmt noted it will continue in the range of ~18%-19% over FY11/12E.
- **Conf-call takeaways** — 1) Two price hikes aggregating 4% have been taken thus far. Another hike of cRs40,000 (new emission standards) will occur in Oct; 2) Mgmt noted current EBITDA margin of 10% has upside bias as a) production at Uttarakhand rises, and b) material costs decline in 2H 3) Industry volume outlook is robust – forecast at 20%. Given YTD growth, implied growth for residual FY11 is 8%. ALL mgmt maintained its earlier guidance of c85,000 vehicles for FY11 with an upside bias, predicated on strong growth in S. India where ALL has 45% market share. 4) Capex + investment in JVs will be ~Rs20bn over FY11/12.
- **Market share trends mixed** — ALL's market share in domestic buses decreased by 170bps QoQ (+660bps YoY on a low 1QFY10) but increased in the truck segment by ~85bps QoQ (1100bps YoY). Overall in the domestic MHCV market, ALL's share increased ~40bps QoQ and ~990bps YoY to 27%.
- **Maintain Sell** — We increase earnings 10% for FY11E (primarily better volumes, given strength in 1Q), & 30% increase in FY12E earnings reflects cost savings from Uttarakhand plant, which mgmt notes will add 150bps to EBITDA margins. Maintain Sell – we think the stock is expensive at these levels. We raise our TP to Rs65, based on 8x Dec11 CEPS. The multiple is at a c20% discount to TTMT. At our TP, the stock trades at an EV/EBITDA of 8x. For reference, we use a multiple of 9x to value TTMT's core business. **TTMT is our preferred pick in the space.**

Sell/Medium Risk	3M
Price (28 Jul 10)	Rs72.50
Target price	Rs65.00
from Rs52.00	
Expected share price return	-10.3%
Expected dividend yield	1.8%
Expected total return	**-8.6%**
Market Cap	Rs96,450M
	US$2,067M

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 (%)
2009A	2,438	1.83	-49.1	39.6	2.8	8.7	1.4
2010A	4,262	3.20	74.8	22.6	2.6	11.9	2.1
2011E	5,952	4.47	39.6	16.2	2.4	15.4	1.8
2012E	8,189	6.16	37.6	11.8	2.1	18.7	1.8
2013E	10,038	7.55	22.6	9.6	1.8	19.8	1.8

Source: Powered by dataCentral

Jamshed Dadabhoy
+91-22-6631-9883
jamshed.dadabhoy@citi.com

Arvind Sharma
+91-22-6631-9852
arvind1.sharma@citi.com

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	39.6	22.6	16.2	11.8	9.6
EV/EBITDA adjusted (x)	23.2	15.3	10.9	7.7	6.4
P/BV (x)	2.8	2.6	2.4	2.1	1.8
Dividend yield (%)	1.4	2.1	1.8	1.8	1.8
Per Share Data (Rs)					
EPS adjusted	1.83	3.20	4.47	6.16	7.55
EPS reported	1.43	3.18	4.47	6.16	7.55
BVPS	26.11	27.58	30.53	35.17	41.19
DPS	1.00	1.50	1.30	1.30	1.30
Profit & Loss (RsM)					
Net sales	59,586	72,090	99,852	117,810	132,681
Operating expenses	-56,901	-66,860	-92,258	-107,369	-120,358
EBIT	**2,685**	**5,231**	**7,594**	**10,442**	**12,323**
Net interest expense	-1,603	-1,019	-1,324	-1,557	-1,319
Non-operating/exceptionals	1,003	1,236	989	1,225	1,389
Pre-tax profit	**2,084**	**5,448**	**7,259**	**10,109**	**12,392**
Tax	-185	-1,211	-1,307	-1,921	-2,355
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	**1,900**	**4,237**	**5,952**	**8,189**	**10,038**
Adjusted earnings	2,438	4,262	5,952	8,189	10,038
Adjusted EBITDA	4,469	7,272	10,045	13,927	15,775
Growth Rates (%)					
Sales	-22.9	21.0	38.5	18.0	12.6
EBIT adjusted	-57.2	94.8	45.2	37.5	18.0
EBITDA adjusted	-44.4	62.7	38.1	38.6	13.3
EPS adjusted	-49.1	74.8	39.6	37.6	22.6
Cash Flow (RsM)					
Operating cash flow	**-898**	**7,718**	**9,392**	**12,899**	**14,878**
Depreciation/amortization	1,784	2,041	2,451	3,486	3,452
Net working capital	-6,175	172	0	0	0
Investing cash flow	**-25,210**	**-6,177**	**-7,500**	**-4,500**	**-1,500**
Capital expenditure	-25,210	-6,177	-7,500	-4,500	-1,500
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	**9,150**	**131**	**2,053**	**-4,023**	**-9,023**
Borrowings	10,706	2,457	4,077	-2,000	-7,000
Dividends paid	-1,556	-2,327	-2,023	-2,023	-2,023
Change in cash	**-16,958**	**1,671**	**3,945**	**4,375**	**4,354**
Balance Sheet (RsM)					
Total assets	**78,363**	**92,820**	**103,008**	**106,704**	**111,898**
Cash & cash equivalent	881	5,189	5,408	2,375	3,372
Accounts receivable	9,580	10,221	10,608	10,523	11,889
Net fixed assets	43,974	48,110	53,159	54,174	52,222
Total liabilities	**43,585**	**56,133**	**62,389**	**59,919**	**57,099**
Accounts payable	17,713	23,317	26,951	25,974	29,337
Total Debt	19,581	22,039	26,116	24,116	17,116
Shareholders' funds	**34,739**	**36,688**	**40,619**	**46,785**	**54,799**
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	7.5	10.1	10.1	11.8	11.9
ROE adjusted	8.7	11.9	15.4	18.7	19.8
ROIC adjusted	6.6	7.4	11.3	14.6	16.9
Net debt to equity	53.8	45.9	51.0	46.5	25.1
Total debt to capital	36.0	37.5	39.1	34.0	23.8

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1QFY11 PAT – Slightly Below Expectations

Figure 1. Ashok Leyland : 1QFY11 Results (Rs. mn)

	1QFY10	4QFY10	1QFY11A	% Chg YoY	% Chg QoQ	CIRA Comments
Net sales	**9,125**	**29,390**	**23,480**	**157%**	**-20%**	**~15% above our estimates. The ASPs were c5% below our estimates**
Decrease/(Increase) in Stocks	374	1,906	(1,136)	-403%	-160%	
Raw Materials	6,252	19,604	18,482	196%	-6%	
Staff costs	1,441	1,807	2,025	41%	12%	~12% above estimates. Impacted by executive salary hikes and negotiations with the worker unions. Unlikely to increase sharply in the future.
Other Expenses	935	1,914	1,755	88%	-8%	12% above estimates – reflects U'khand plant commissioning
Total Expenditure	**9,003**	**25,230**	**21,126**	**135%**	**-16%**	
EBITDA	**122**	**4,160**	**2,354**	**1835%**	**-43%**	**~4% below estimates.**
Interest	258	221	316	23%	43%	Rise in interest cost due to 1) Fresh debt raised in 2HFY10 and 2)Lower capitalization of interests after the Pantnagar plant became operational in Mar 2010
Other income	91	23	47	-48%	105%	
EBDT	(45)	3,962	2,085	nm	-47%	
Depreciation & Amortization	435	588	615	41%	5%	Hike in depreciation due to new plant commissioned at Pantnagar
PBT	(480)	3,374	1,470	nm	-56%	
Exceptional income	515					
Exceptional expenditure	(10)	380				
Tax	(53)	768	244	-559%	-68%	Incentive on higher R&D expense helped ease the tax burden
PAT	78	2,227	1,226	1478%	-45%	
PAT (pre exceptionals)	**(427)**	**2,520**	**1,226**	**nm**	**-51%**	
Profit Margins						
EBITDA Margin (%)	1.3	14.2	10.0			
Tax / PBT (%)	-217.1	20.5	16.6			
Per-tax margins	-5.3	11.5	6.3			
Net profit margins (%)	-4.7	8.6	5.2			
Cost ratios						
Raw materials / sales	72.6	73.2	73.9			
Staff costs / sales	15.8	6.1	8.6			
Other expenses / sales	10.2	6.5	7.5			~100bps increase QoQ, negatively impacted EBITDA margins
EPS (Rs)	-0.32	1.89	0.92			
CEPS (Rs)	0.01	2.34	1.38			

Source: Company Reports, Citi Investment Research and Analysis

Figure 2. Ashok Leyland: Revenue/profitability trends (Rs.)

	1QFY10	4QFY10	1QFY11A	% Chg YoY	% Chg QoQ
Average Realisations (Rs m)	1,185,309	1,138,854	1,097,083	-7%	-4%
Material Cost / Vehicle	860,837	833,470	810,485	-6%	-3%
Gross Contribution / Vehicle	324,473	305,384	286,599	-12%	-6%
EBITDA / Vehicle	15,805	161,196	109,990	596%	-32%

Source: Company Reports, Citi Investment Research and Analysis

Conf-call Takeaways

1) Price hikes of 4% thus far in FY11—ALL mgmt took two price hikes (1.5% in Apr10 and 2.5% in July). These price hikes were mainly to ease the burden of raw material price increase, notably rubber and steel. In addition to this, when the new emission norms (BS III) come into effect in October, ALL plans to transfer the entire burden of cRs 40,000/vehicle to the customers.

2) EBITDA margin guidance maintained at 10% with upside bias — ALL mgmt aims to maintain the 10% EBITDA margin of 1QFY11 for the year. Price hikes (actual + planned) should ensure margins remain stable. Given ALL's weak competitive positioning, its ability to pass through price hikes will be a function of what competitor TTMT does. As the Pantnagar plant output ramps up, margins may improve due to better operational leverage as well as cost savings from that facility (mgmt has indicated savings of ~Rs30k/vehicle – our FY12 estimates factor this savings into our forecasts).

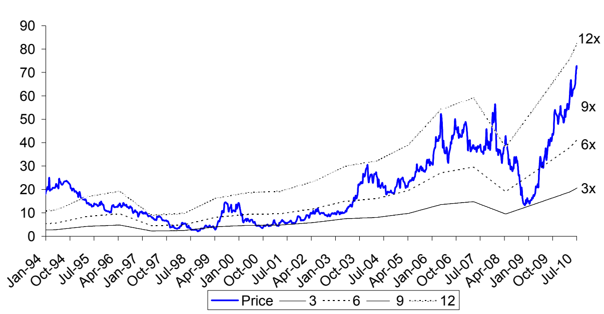
3) New ventures in pipeline—Among the Joint Ventures that the company has entered into, the construction equipment JV will begin operations in early 4QFY11. Sales from the LCV JV with Nissan will start by 1QFY12. The high-pressure die casting JV with Alteams has started production and has resulted in savings of ~5% in the components sourced by ALL.

Figure 3. Ashok Leyland: Earnings Revision Table (Rs mn)

	Old		New		Deviation	
	FY2011E	**FY2012E**	**FY2011E**	**FY2012E**	**FY2011E**	**FY2012E**
Domestic Volumes	67,896	77,229	77,850	88,561	14.7%	14.7%
Export Volumes	7,188	8,266	7,672	8,823	6.7%	6.7%
Total Volumes	**75,084**	**85,495**	**85,522**	**97,384**	**13.9%**	**13.9%**
Net sales	**88,942**	**102,612**	**99,852**	**117,810**	**12.3%**	**14.8%**
EBITDA	9,534	10,631	10,045	13,927	5.4%	31.0%
EBITDA Margin (%)	11%	10%	10%	12%		
PBT	6,647	7,802	7,259	10,109	9.2%	29.6%
Tax (Rs)	1,263	1,482	1,307	1,921	3.5%	29.6%
Tax Rate	19%	19%	18%	19%		
PAT	**5,384**	**6,320**	**5,952**	**8,189**	**10.5%**	**29.6%**
PAT Margin (%)	6%	6%	6%	7%		

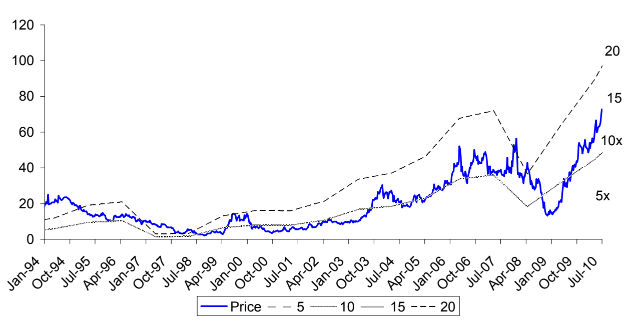
Source: Citi Investment Research and Analysis estimates

Figure 4. Ashok Leyland : 1 Yr Fwd P / CEPS (x)



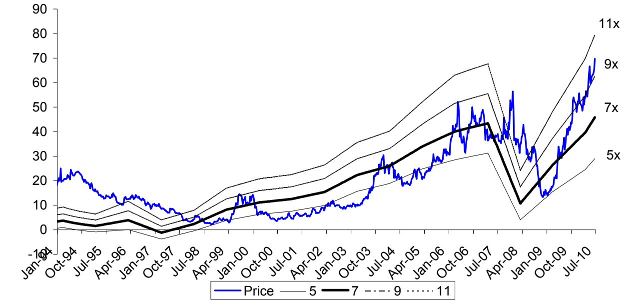
Source: Company, Citi Investment Research and Analysis

Figure 5. Ashok Leyland : 1 Yr Fwd P / EPS (x)



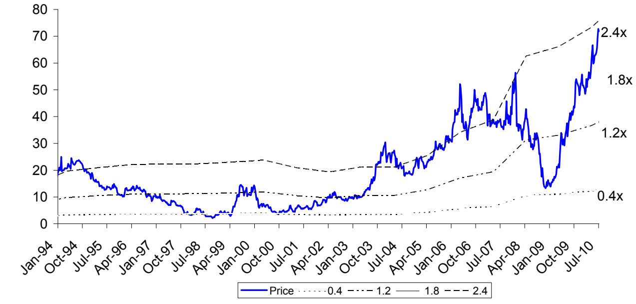
Source: Company, Citi Investment Research and Analysis

Figure 6. Ashok Leyland : 1 Yr Fwd EV / EBITDA (x)



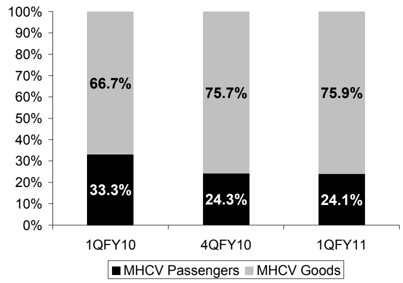
Source: Company, Citi Investment Research and Analysis

Figure 7. Ashok Leyland : 1 Yr Fwd P/ BVPS (x)



Source: Company, Citi Investment Research and Analysis

Figure 9. MHCV : Goods / Passenger Mix



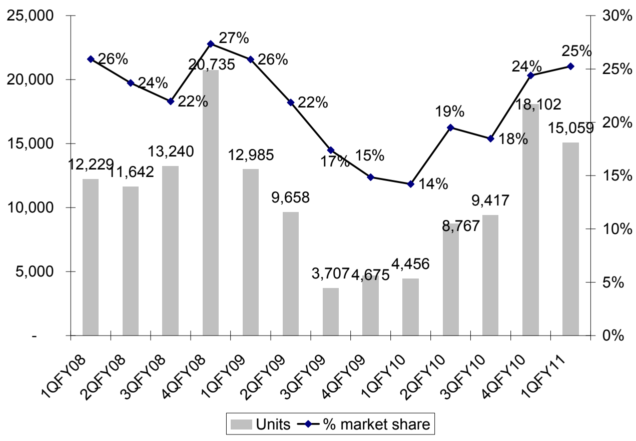
Source: Company, CIRA

Figure 8. Ashok Leyland: Operational Statistics

	1QFY10	4QFY10	1QFY11	% Chg YoY	% Chg QoQ
MHCV Passenger					
Domestic Sales	2,211	5,485	4,184	89%	-24%
Export sales	274	695	904	230%	30%
Total MHCV Passenger Sales	**2,485**	**6,180**	**5,088**	**105%**	**-18%**
MHCV Goods					
Domestic Sales	4,456	18,102	15,059	238%	-17%
Export sales	526	1,202	980	86%	-18%
Total MHCV Goods Sales	**4,982**	**19,304**	**16,039**	**222%**	**-17%**
LCV					
Domestic Sales	128	264	219	71%	-17%
Export sales	103	59	56	-46%	-5%
Total LCV Sales	**231**	**323**	**275**	**19%**	**-15%**
Total Domestic	6,795	23,851	19,462	186%	-18%
Total Export	903	1,956	1,940	115%	-1%
Total Sales	**7,698**	**25,807**	**21,402**	**178%**	**-17%**

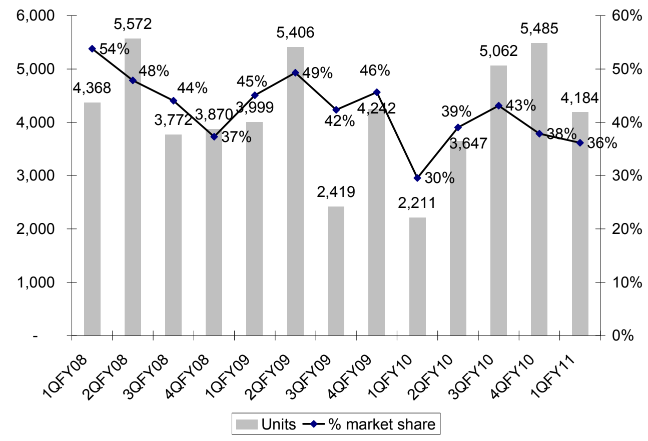
Source: Company Reports, Citi Investment Research and Analysis

Figure 10. Ashok Leyland : Domestic Goods MHCV Sales Trend



Source: SIAM

Figure 11. Ashok Leyland : Domestic Passenger MHCV Sales Trend



Source: SIAM

Ashok Leyland (ASOK.BO; Rs72.50; 3M)

Company description

Ashok Leyland (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 rate ALL as Sell/Medium Risk. Growth prospects for ALL are improving. Over the near-term, economic growth is expected to rebound, though we don’t expect commercial vehicle sales to rebound very dramatically, given the nascent revival in the investment cycle. 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 Rs65 for ALL is based on an 8x P/CEPS on Dec11E CEPS. We revert to our cash earnings based methodology as we expect earnings volatility to reduce into 2HFY11 as the CV cycle gradually improves. Our 8x target multiple is in line with historical average of 8.1x. At present, the stock is trading at ~16x P/E on FY11 EPS.

Risks

We rate ALL Medium Risk, in line with the rating assigned by our quantitative risk-rating system, which tracks 260-day historical share-price volatility. Medium Risk is also 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.

Tata Motors (TAMO.BO; Rs851.95; 1M)

Valuation

Our Rs947 target price for Tata Motors is based on a sum-of-the-parts valuation. We value Tata Motors' core business at Rs759/share (on a diluted share count of 570m shares), based on 9x Sep 11E EV/EBITDA. We value subsidiaries and investments at Rs83/share (incorporating a 20% holding company discount). We attribute around Rs104/share to JLR - we value this at 4.5x Sep 11E EV/EBITDA, which equates to around Rs492/share and then deduct the total net debt which amounts to around Rs388/share. At our target price, TTMT would trade at a consolidated price-to-book value of 3.7x / 2.7x (FY11/12E), which appears reasonable when juxtaposed against ROEs of 39.5%, 34.9% in FY11E/12E respectively. On a P/E basis, the stock would trade at ~11x and 9x FY11E/12E P/E.

Risks

Our quantitative risk rating system, which tracks 260-day historical share price volatility, suggests a High Risk rating for Tata Motors shares. We assign a Medium Risk flag, however, as a) the short-term debt raised to fund the JLR deal has been refinanced, and b) the core CV business has improved sequentially from 3QFY09 lows.

The key risks that could prevent the shares from reaching our target price emanate from: a) Weaker-than-forecast demand conditions for luxury cars and SUVs in Europe and the US. Given the high leverage of this business to both volumes and EPS, the key risk is if JLR volumes are lower than anticipated; b) Our CV forecasts are predicated on our economist Rohini Malkani's view that industrial growth should remain fairly healthy (in the 8-9% range), in both FY11/12E. We have assumed that MHCV volume growth will be fairly tepid in FY11E (around 5%), given the emission change over and also the (expected) roll-back in excise incentives; c) We assume that the credit and liquidity environment will remain stable. A credit 'crunch' could impact consumer confidence and possibly JLR's sales (especially in developed markets). Given TTMT's highly leveraged balance sheet, this is a significant risk. We also implicitly assume that TTMT will raise equity over the next 1 year to rectify its balance sheet. A credit shock (followed by a dislocation in the equity markets) could delay the restructuring of the balance sheet.

Appendix A-1

Analyst Certification

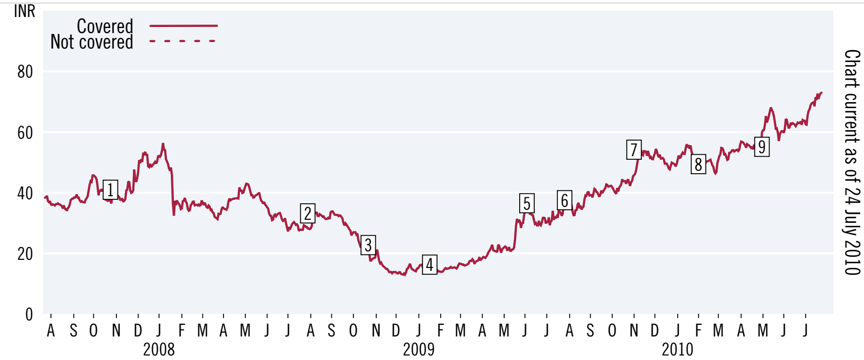
The research analyst(s) primarily responsible for the preparation and content of all or any identified portion of this research report hereby certifies that, with respect to each issuer or security or any identified portion of the report with respect to an issuer or security that the research analyst covers in this research report, all of the views expressed in this research report accurately reflect their personal views about those issuer(s) or securities. The research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this research report.

IMPORTANT DISCLOSURES

Ashok Leyland (ASOK.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy



Date	Rating	Target Price	Closing Price
1 24-Oct-07	3L	*38.00	37.15
2 29-Jul-08	3L	*26.00	28.20
3 22-Oct-08	*3M	*19.00	20.60
4 16-Jan-09	3M	*12.00	15.00
5 3-Jun-09	3M	*29.00	36.30
6 27-Jul-09	3M	*28.00	34.95
7 2-Nov-09	3M	*43.00	45.45
8 1-Feb-10	3M	*49.00	51.65
9 30-Apr-10	3M	*52.00	59.95

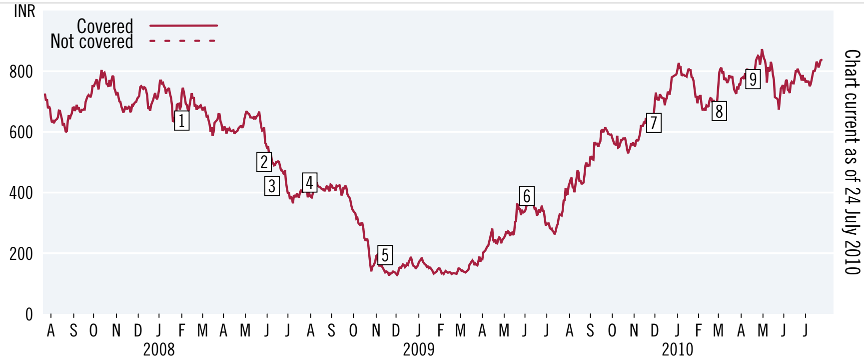
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tata Motors (TAMO.BO)

Ratings and Target Price History
Fundamental Research

Analyst: Jamshed Dadabhoy



Date	Rating	Target Price	Closing Price
1 1-Feb-08	1L	*885.15	730.49
2 28-May-08	1L	*766.03	614.71
3 8-Jun-08	*1M	*651.75	523.00
4 31-Jul-08	*2M	*458.07	390.52
5 14-Nov-08	*2H	*163.00	136.95
6 3-Jun-09	*2M	*384.00	362.00
7 30-Nov-09	*1M	*828.00	660.90
8 2-Mar-10	1M	*851.00	797.10
9 19-Apr-10	1M	*947.00	775.45

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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Citigroup Global Markets Inc. or an affiliate received compensation for products and services other than investment banking services from Ashok Leyland, Tata Motors in the past 12 months.

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Citigroup Global Markets Inc. currently has, or had within the past 12 months, the following as clients, and the services provided were non-investment-banking, securities-related: Ashok Leyland, Tata Motors.

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Rohini Malkani has in the past worked with the India government or its divisions in her personal capacity.

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