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# Ashok Leyland

**1QFY2010 Result Update**

## NEUTRAL

| | |
|---|---|
| **Price** | **Rs35** |
| **Target Price** | **-** |
| **Investment Period** | **-** |

| **Stock Info** | |
|---|---|
| Sector | Automobile |
| Market Cap (Rs cr) | 4,656 |
| Beta | 0.8 |
| 52 WK High / Low | 38/12 |
| Avg Daily Volume | 1039294 |
| Face Value (Rs) | 1 |
| BSE Sensex | 15,332 |
| Nifty | 4,564 |
| BSE Code | 500477 |
| NSE Code | ASHOKLEY |
| Reuters Code | ASOK.BO |
| Bloomberg Code | AL@IN |

| **Shareholding Pattern (%)** | |
|---|---|
| Promoters | 38.6 |
| MF/Banks/Indian FIs | 22.4 |
| FII/ NRIs/ OCBs | 25.3 |
| Indian Public | 13.7 |

| **Abs.** | **3m** | **1yr** | **3yr** |
|---|---|---|---|
| Sensex (%) | 39.4 | 6.8 | 43.6 |
| ALL (%) | 72.8 | 21.7 | (0.1) |


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## Performance Highlights

- **Sales in line, Net Profit marginally lower than expectation:** For 1QFY2010, Ashok Leyland (ALL) reported a 51.6% yoy decline in Net Sales to Rs912.5cr, which was lower than our expectation of Rs984cr. Sales came in better in spite of a 63.1% yoy fall in Volumes, primarily due to the change in the product mix, which resulted in better average realisation growth during the quarter. Engine sales declined by around 7.4% yoy to 4,446 units largely due to a negotiation on the pricing front for annual contracts. It contributed about 9-10% to the Revenue in 1QFY2010. The company's Bottom-line, which posted an 84.7% yoy decline to Rs7.8cr, came in lower than our expectation for the quarter, owing to a substantial decline in the OPM.

- **Low operating leverage impacts Margins:** During 1QFY2010, ALL witnessed a 680bp yoy decline in EBITDA Margins. This was mainly on account of low operating leverage during the quarter, which led to a substantial increase in the Staff cost to Sales, and the Other Expenditure to Sales ratios for the quarter. Other Expenditure, on overall terms, however, declined 29% yoy (Rs38cr), largely due to AS11, a reduced production activity level and an absolute saving of around Rs12cr due to cost cutting measures. Raw Material Costs fell by 369bp yoy, and accounted for 72.6% (76.3%) of Sales. The price negotiation with the suppliers helped prune its overall Raw Material Costs during the quarter. ALL reported a 92.6% yoy decline in Operating Profits to Rs11.1cr for 1QFY2010.

- **Higher Other Income restricts Net Profit fall:** Net Profit, which declined 84.7% yoy to Rs7.8cr (Rs50.6cr), came in below expectations, owing to a higher Other Income of Rs60.6cr (Rs12.2cr), up 398.1% yoy. However, a higher Interest Cost of Rs25.8cr (Rs10.7cr) mitigated the effect of higher Other Income on the Bottom-line, to a certain extent. A Deferred Tax reversal of about Rs5.3cr further supported the NPM. Moreover, single-shift working during the quarter helped to maintain Depreciation at Rs43.5cr (Rs44.1cr), despite an increase in the capital expenditure.

### Key Financials

| Y/E March (Rs cr) | FY2008 | FY2009 | FY2010E | FY2011E |
|---|---|---|---|---|
| **Net Sales** | **7,936** | **6,126** | **6,540** | **7,746** |
| *% chg* | *8.4* | *(22.8)* | *6.8* | *18.4* |
| **Net Profit** | **450.8** | **178.8** | **190.6** | **315.7** |
| *% chg* | *5.9* | *(60.3)* | *6.6* | *65.6* |
| OPM (%) | 10.2 | 7.4 | 8.8 | 9.7 |
| **EPS (Rs)** | **3.4** | **1.3** | **1.4** | **2.4** |
| P/E (x) | 10.3 | 26.0 | 24.4 | 14.7 |
| P/BV (x) | 2.2 | 2.2 | 2.2 | 2.1 |
| RoE (%) | 22.1 | 9.0 | 9.0 | 14.3 |
| RoCE (%) | 19.3 | 6.4 | 5.4 | 7.1 |
| EV/Sales (x) | 0.6 | 1.0 | 0.9 | 0.7 |
| EV/EBITDA (x) | 6.3 | 14.3 | 10.8 | 8.6 |

*Source: Company, Angel Research*

## Conference Call – Key Highlights

- **Volume and Market share:** The company's Domestic M&HCV Segment de-grew 33.2% yoy in FY2009 and further by 65.4% yoy in 1QFY2010. ALL registered a 34.6% decline in Volumes, which resulted in its M&HCV market share dipping to 25.7% (27.5%) in FY2009, and to almost 17.2% at the end of 1QFY2010. Truck demand remains weak, especially for tractor trailers (export-led) and multi-axle vehicles (construction-led), which are strong segments for ALL. While freight rates are showing some signs of improvement in the southern and western regions, they continue to decline in the eastern and northern regions. The management's domestic truck volume estimate for FY2010 is for positive single digit growth, aided by a continuation of measures taken by the government and benign interest rates.

  The JNNURM programme for urban fleet modernisation calls for the mobilisation of 14,000 vehicles. Out of this, orders for 5,300 vehicles have already been placed, with ALL bagging orders for 2,800. These orders would be executed in 2QFY2010. Out of the remaining 9,000 vehicles, the management expects orders for 4,500 vehicles to come through. Assuming that other segments for bus demand remain stable, the additional 2,800 vehicles would result in around a 20% growth in the Bus Segment.

**Exhibit 1: Volume Growth**

| Segment | 1QFY2010 | 1QFY2009 | % chg | FY2009 | FY2008 | % chg |
|---|---|---|---|---|---|---|
| MDV Passenger | 2,485 | 7,175 | *(65.4)* | 19,745 | 22,262 | *(11.3)* |
| MDV Goods | 4,982 | 13,450 | *(63.0)* | 33,349 | 60,224 | *(44.6)* |
| LCV | 231 | 245 | *(5.7)* | 1,350 | 825 | *63.6* |
| Export (Inc. Above) | 903 | 1,280 | *(29.5)* | 6,812 | 7,286 | *(6.5)* |
| **Total** | **7,698** | **20,870** | *(63.1)* | **54,444** | **83,311** | *(34.6)* |

*Source: Company, Angel Research*

- **Cutting down inventory and operating cost:** The company managed to cut down its inventory to 6,331 units in 1QFY2010 from around 10,398units in 3QFY2009. The company plans to further reduce it by another 2,000-2,500 units in the next quarter. Overall, ALL expects these measures to lower its working capital costs by around Rs500cr (from around Rs1,500cr currently), over the next couple of quarters, which also increased Interest costs in the last couple of quarters and exerted pressure on the Bottom-line.
  Further, the prices of most raw materials used in a truck, steel, copper, lead, zinc and rubber, have declined by 25-60% in the last year. The management expects a benefit of Rs45,000 per vehicle (250-300bp), if the company is able to hold on to the entire benefit. The company secured cost reductions of Rs25,000 by April 2009, without passing on the price reductions. Additionally, ALL has also taken a price hike of about 2% in July 2009.

- **New capacities:** ALL had planned to more than double its capacity of 84,000 vehicles per annum over the next three years, and earmarked capex of Rs3,000cr for FY2009-11E. However, owing to the ongoing slowdown, it has announced that it would be rationalising its capex plans. During FY2009, the company incurred capex of close to Rs950cr, with a major part being utilised for its Uttaranchal plant. For FY2010E, ALL plans to incur capex to the extent of Rs600-700cr. Further, over the next two to three years, ALL plans to invest Rs2,000cr towards capacity addition. The company is looking to raise about Rs400cr from the market, through a combination of debt and equity, depending on the feasibility.

  The total expenditure on its Uttaranchal plant is expected to be close to Rs1,300cr (as against the earlier planned Rs2,300cr), out of which Rs800cr has already been expensed out. The capacity addition from this capex would be close to 50,000 vehicles (as against the earlier planned 70,000 vehicles). The total capacity, post the Uttaranchal capacity addition, is estimated to be around 150,000 vehicles by March 2010E. This will strengthen ALL's presence in the North, which contributes one-fourth of its Sales. The investments will enjoy Excise and Income Tax exemption/concession for five to ten years. ALL plans to complete its Uttaranchal expansion by 2010. The Uttaranchal plant is expected to start operations by 4QFY2010E, though the volume would pickup only in FY2011E.

- **ALL-Nissan JV:** ALL has entered into an initial agreement to form a joint venture (JV) with Nissan Motor Company for the development, manufacture and distribution of light commercial vehicle (LCV) products. As ALL has a negligible presence in the LCV space, this partnership would be positive for it in the long run. The two companies may also share each others' dealer networks in India and overseas, as an extension of this partnership. Earlier, the JV had targeted production of 1,00,000 LCVs annually, for both the domestic and international markets. However, the company is now revising its capacity addition plans due to the ongoing economic slowdown. Both Nissan and ALL expect vehicle roll-outs to start from the JV from FY2011E, a delay of six months.

## Outlook and Valuation

We estimate ALL to clock EPS of Rs1.4 in FY2010E and Rs2.4 in FY2011E. At the CMP, the stock is trading at 24.4x FY2010E and 14.7x FY2011E EPS. A majority of the factors that drive freight demand and, consequently, M&HCV demand are expected to turn positive in the medium term. We expect the CV manufacturers to benefit from the expected economic recovery in 2HFY2010E. **We advise investors to enter the stock at lower levels to play out the turn in the economic and commercial vehicle (CV) cycles. However, due to the recent run up in its price, we maintain a Neutral rating on the stock.**

**Exhibit 2: 1QFY2010 Performance**

| Y/E Mar (Rs cr) | 1QFY2010 | 1QFY2009 | *% chg* | FY2009 | FY2008 | *% chg* |
|---|---|---|---|---|---|---|
| **Net Sales** | **912.5** | **1,883.9** | ***(51.6)*** | **6,126.0** | **7,935.5** | ***(22.8)*** |
| Other Income | 60.6 | 12.2 | *398.1* | 91.2 | 84.2 | *8.4* |
| **Total Income** | **973.1** | **1,896.0** | ***(48.7)*** | **6,217.2** | **8,019.7** | ***(22.5)*** |
| EBITDA | 11.1 | 151.1 | *(92.6)* | 456.0 | 807.6 | *(43.5)* |
| **OPM (%)** | **1.2** | **8.0** | | **7.4** | **10.2** | |
| Interest | 25.8 | 10.7 | *141.3* | 160.3 | 76.3 | *110.1* |
| Depreciation | 43.5 | 44.1 | *(1.4)* | 178.4 | 177.4 | *0.6* |
| PBT | 2.4 | 74.5 | *(96.7)* | 208.5 | 638.1 | *(67.3)* |
| Tax | (5.3) | 21.8 | | 18.5 | 168.8 | |
| EOI | 0.0 | 2.2 | - | 11.2 | 18.6 | *(39.6)* |
| **PAT and EOI** | **7.8** | **50.6** | ***(84.7)*** | **190.0** | **450.8** | ***(57.9)*** |
| **EPS (Rs)** | **0.1** | **0.4** | | **1.3** | **3.4** | |

*Source: Company, Angel Research*

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| | | | |
|---|---|---|---|
| **Ratings (Returns) :** | **Buy (Upside > 15%)** | **Accumulate (Upside upto 15%)** | **Neutral (5 to -5%)** |
| | **Reduce (Downside upto 15%)** | **Sell (Downside > 15%)** | |