Prabhudas Lilladher

Ashok Leyland

Non cyclical business to drive growth

May 27, 2008

Rating	**Market Performer**
Price	Rs37
Target Price	Rs43
Implied Upside	15.9%
Sensex	16,348

(Prices as on May 26, 2008)

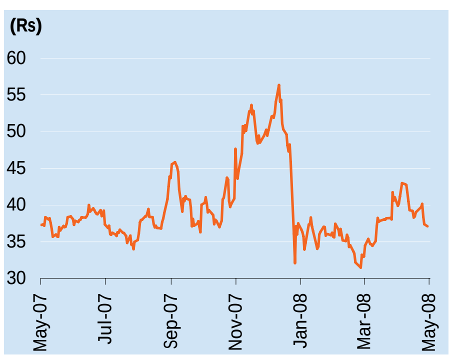
Trading Data	
Market Cap. (Rs bn)	49.4
Shares o/s (m)	1,330.3
Free Float	61.4%
3M Avg. Daily Vol ('000)	5,902.4
3M Avg. Daily Value (Rs m)	225.0

Major Shareholders	
Promoters	38.6%
Foreign	11.8%
Domestic Inst.	30.9%
Public & Others	18.7%

Stock Performance

(%)	1M	6M	12M
Absolute	(9.6)	(22.1)	(0.8)
Relative	(5.8)	(8.2)	(15.6)

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



Source: Bloomberg

- **FY09 expected to be better:** Ashok Leyland witnessed a 1% decline in volumes in FY08 in line with the industry trend. The management expects the industry to grow in the higher single digit in FY09 and hopes to increase its market share to 30% (currently at 28.6%) in FY09 backed by a slew of new launches across segments.

- **Future growth drivers:** The company expects a very strong growth from the Tractor Trailer and Tipper segments. With the commodity cycle in a cyclical upturn, the demand for mining tippers is expected to be robust for FY09 as well. Ashok Leyland expects its non-cyclical business (bus, exports, engines, spare parts and defence kits) to contribute to about 45% to the overall revenues from the current 33% by FY09.

- **Capex plans:** Ashok Leyland plans to ramp up its capacity to 1,84,000 vehicles from the current 84,000 vehicles over 2years at an estimated capex of Rs 3.3bn. The capex would be funded by debt and internal accruals.

- **Outlook & Valuation:** The company has given a volume guidance of about 10-12% growth in FY09 backed by a slew of launches and increasing contribution from the non-cyclical business.

  The company has taken a price hike of 2.5% in April 08 to compensate for the rising raw material costs. The management has indicated that it will strive to maintain its margins at 10%. The scrip currently trades at 10.2x FY09E EPS of Rs3.7 and 8.6x FY10E EPS of Rs4.3. We maintain Market Performer rating on the stock.

Key financials (Y/e March)	FY07	FY08	FY09E	FY10E
Revenue (Rs m)	71,682	77,291	89,591	107,977
Growth (%)	*36.6*	*7.8*	*15.9*	*20.5*
EBITDA (Rs m)	7,027	8,040	9,285	11,509
PAT (Rs m)	4,316	4,777	4,857	5,738
EPS (Rs)	3.2	3.6	3.7	4.3
Growth (%)	*41.2*	*10.7*	*1.7*	*18.1*
Net DPS (Rs)	1.3	1.5	1.5	1.8

Source: Company Data; PL Research

Profitability & valuation	FY07	FY08	FY09E	FY10E
EBITDA margin (%)	*9.8*	*10.4*	*10.4*	*10.7*
RoE (%)	*26.1*	*23.7*	*21.4*	*22.4*
RoCE (%)	*17.4*	*15.5*	*12.5*	*12.8*
EV / sales (x)	0.7	0.7	0.7	0.6
EV / EBITDA (x)	7.0	6.7	6.5	5.8
PE (x)	11.4	10.3	10.2	8.6
P / BV (x)	2.6	2.3	2.1	1.8
Net dividend yield (%)	*3.4*	*4.0*	*4.0*	*4.7*

Source: Company Data; PL Research

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Management representatives:
Mr. K Sridharan, CFO

Q: What have been the key features of the CV industry in FY08? How has been Ashok Leyland's performance during the year?

A: The commercial vehicle industry witnessed a marginal 1% fall in FY08 after 6 years of consistent growth. While the goods segment was down 6% yoy, the bus segment witnessed a 35% growth in the year. The decline in the goods segment was primarily due to a higher base effect in the MAV and the 4x2 haulage segment. Bus segment witnessed a robust 35% growth backed by a significant scale up in operations by private operators in certain states.

Our bus segment outgrew the industry with a 50% growth as some of the recent launches were well accepted by the market. However, we witnessed a 11% fall in the goods segment in FY08. While the fall was in line with the industry trend the sharper fall was primarily due to capacity constraints.

Q: Is the large base created in FY07 a reason for the de-growth?

A: The decline witnessed in MAV and 4x2 haulage segment is the impact of the higher base created in FY07. However, our recent conversation with dealers and freight operators indicate that availability of freight is not an issue. However, the current stringent financing norms adopted by financial institutions has led to the slow-down in the demand in the entire automobile industry.

Q: What kind of a growth do you expect for the industry and Ashok Leyland in FY09?

A: We expect the industry to post a higher single digit growth in FY09 and we are internally targeting a 30% market share (current 28.6%) in the CV industry backed by a slew of new launches across segment. To achieve our target, we need to post a double digit growth in FY09.

Q: What would be the key growth drivers for Ashok Leyland in FY09?

A: While the goods segment may witness a subdued growth, we expect a very strong demand from the tipper and tractor trailer segment. Our recently launched products like a *4921TT* and the *2518 mining tipper* have been very well accepted in the market. With the commodity cycle in a cyclical upturn, the demand for mining tippers is expected to be robust for FY09. Also, we expect our non-cyclical business (bus, exports, engines, spare parts and defence kits) to contribute to about 45% to the overall revenues from the current 33% by FY09.

Q: Could you elaborate on the growth from your non-cyclical business?

A: Our non-cyclical business consists of revenues from bus, exports, engines and spares and defense.

Our bus segment grew by about 50% in FY08 and this robust growth is expected to continue in FY09 as well.

Our exports, in volume terms, were up 21% to 7,285 vehicles in FY08. With the newly launched cab vehicle suited for the export market, new manufacturing facility at Ras Al Khaimah, thrust on markets identified in ASEAN and African countires, we expect this growth rate to sustain. We are targeting a 25% yoy growth in exports over the next 3 years to 30,000 vehicles.

Our genset business witnessed a 37% jump in revenues in FY08 due to low power engines (30-75HP) imported from China. These engines are mainly used in telecom towers. We expect to sell about 10,000 engines (as against 1,500enginesin FY08) in FY09.

With strong growth from these 3 segments, we expect our non-cyclical revenues to be about 45% of sales by FY09.

Q: Have you taken price hikes to compensate for the rising cost pressures?

A: We have taken a 2.5% increase in prices wef Apr2008. However, this will only partly compensate for the rising cost pressures. While the Government has asked steel companies to reduce prices by about Rs 4,000 / T, the proposal has yet to be implemented by the steel companies. If steel prices are not reduced as indicated, we may hike prices in July / August 2008 again.

Q: Would you be able to maintain your margins considering the rising input cost scenario?

A: While rising raw material costs would continue to be a problem, we would partially mitigate the impact through alternative raw material sourcing from China and aggressive value engineering initiatives. We would strive to maintain our margins at 10% in FY09.

Q: What are your capex plans and how do you plan to fund the same?

A: We are expanding our current capacity from 84,000 units to 1,84,000 units by FY10E at a capex of Rs 3.3bn over the next 3years. We have already raised USD 200mn ECB in Jan08 of which only USD 20mn has been utilised as yet. While an additional R 17bn would be raised through debt, the balance would be raised through internal accruals.

Q: Can you throw some light on your JV with Nissan?

Our JV with Nissan would be primarily for the manufacture of LCVs at an investment of about Rs 23bn contributed equally by the two partners and is expected to commence production from 2010.

Q: Media reports indicate that you plan to enter the construction equipment business? Your comments

A: With the robust growth in the construction sector, we are planning to enter the construction equipment business. We are currently scouting for foreign partner for a JV and our in very premature stages of discussion with some of the players.

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PL's Recommendation Nomenclature

BUY	:	> 15% Outperformance to BSE Sensex	**Outperformer** (OP)	:	5 to 15% Outperformance to Sensex
Market Performer (MP)	:	-5 to 5% of Sensex Movement	**Underperformer** (UP)	:	-5 to -15% of Underperformace to Sensex
Sell	:	<-15% Relative to Sensex			
Not Rated (NR)	:	No specific call on the stock	**Under Review** (UR)	:	Rating likely to change shortly