Ashok Leyland

CMP: Rs 36 | **Target: Rs 48** | **BUY**

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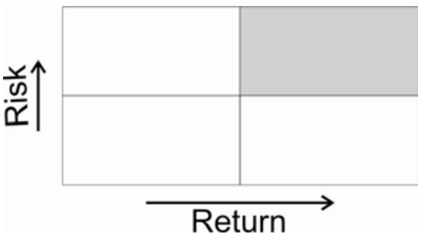
BSE Code	500477
NSE Code	ASHOKLEY
Sensex	14,003
Nifty	4,113

Risk-return profile



Company data

Particulars	
Market cap (Rs bn / US$ bn)	47.7/1.2
Outstanding equity shares (mn)	1,323.9
Free float (%)	61.2
52-week high/low (Rs)	52/31
6-month average daily volume	5,209,805

Stock performance

Returns (%)	1-mth	3-mth	6-mth
Ashok Leyland	(4.7)	(4.6)	(8.8)
Sensex	0.3	7.9	6.2
BSE Auto	(6.4)	(4.9)	(7.4)

Shareholding pattern

(%)	Mar-07	Dec-06
Promoters	38.8	38.8
FIIs	26.2	26.1
Banks & FIs	20.3	20.5
Public & Others	14.7	14.6

Source: BSE

Rolling ahead smoothly

Large-scale capacity expansion amid rising vehicular demand to fuel performance

- Q4FY07 results in line with expectations. PAT grew 21% YoY in Q4FY07 and 46% in FY07
- Recent acquisition of Avia (Czech Republican company) to increase product range and geographical reach
- Aggressive Rs 40bn capacity expansion plans over the next 3-4 years which include setting up a cab and vehicle assembly facility at Uttaranchal
- PAT CAGR of 11% expected over FY07-FY09 to Rs 6bn, driven by a 13% CAGR in revenue and a 60bps improvement in EBITDA margin
- We initiate coverage with Buy with an end-FY08 target price of Rs 48, which represents a potential upside of 33% from the current level

Financial snapshot

(Rs bn)	Sales	PAT	FDEPS (Rs)	P/E (x)	EV/EBITDA	RoE (%)
FY07	71.7	4.4	3.3	10.8	7.1	28.6
FY08E	81.5	5.1	3.8	9.4	6.7	27.6
FY09E	91.5	5.5	4.1	8.7	6.2	25.3

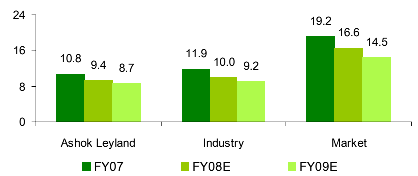
Source: Company, Religare Research

Growth profile

(%)	Sales	EBITDA	PAT	FDEPS
FY07	34.5	32.2	45.9	34.6
FY08E	13.7	17.3	14.8	14.8
FY09E	12.3	15.4	8.1	8.1

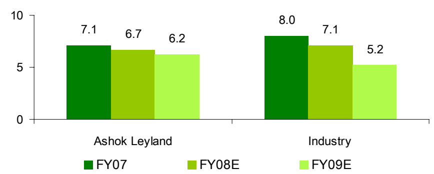
Source: Religare Research

P/E multiple (x)



Source: Religare Research

EV/EBITDA multiple (x)



Source: Religare Research

We expect Ashok Leyland (ALL) to be a major beneficiary of the strong growth prospects for the domestic freight industry. India's robust economy and rapid infrastructure growth is expected to boost road freight demand as well as replacement demand for ageing vehicles. Accordingly, we expect ALL to record a sales volume CAGR of 10% over FY07-FY09, resulting in 13% revenue CAGR and 12% PAT CAGR. The company is foraying into the LCV business as well, which is likely to accelerate with the acquisition of Avia (of the Czech Republic). ALL is also seeking a strategic partner that would provide access to new products and technology.

Company overview

Ashok Leyland (ALL), a part of the Hinduja Group, is the second largest manufacturer of commercial vehicles (CV) in India with a capacity of nearly 90,000 vehicles p.a. The company has manufacturing facilities in six locations comprising the mother plant at Ennore (near Chennai), two plants at Hosur (Hosur I and Hosur II, along with a press shop), and the assembly plant at Alwar (Rajasthan) and Bhandara (Maharashtra). Net sales and net income in FY07 were Rs 72bn and Rs 4.4bn, respectively.

Acquisition of Avia's truck unit

Acquisition of Avia's truck unit will extend geographical reach to the EU

ALL recently acquired the truck unit of Czech Republic-based Avia for US$ 35m. Avia manufactures LCVs in the range of 6-9 tonnes and has a capacity of 20,000 units per annum. The acquisition has given ALL ready access to the entire range of Avia trucks, as well as Avia's press shop with dies and tools, welding lines, paint shop and R&D facilities. We believe the acquisition should help the company to expand its geographical reach to the European Union, with the eastern European markets providing a base for assembling vehicles.

The company has plans to scale up production at Avia's plant to enter new markets including the Middle East, Southeast Asia and Russia. ALL also plans to introduce the Avia range of products in India in a phased manner.

On the lookout for a strategic partner

The promoters of ALL, Land Rover Leyland International Holdings (LRLIH), are scouting for a strategic partner. Some global giants like Volvo, Scania and Daimler-Benz have already expressed their interest in picking up a stake in the company. We believe the inclusion of a strategic partner will be positive for ALL and provide access to the latest products and technology of the new partner.

New product launches

During the year, the company launched *Comet 1611*, a factory-built fuel-efficient cab customised to specific industry requirements. Going forward, ALL is expected to launch the top-end *Intercentury Luxura* buses by end-Q1FY08. The launch is in line with the company's strategy to gain 50% market share in the luxury bus segment. The company has further plans to launch tippers (8x4 with 350 hp engine), branded buses and customised vehicles for the defence sector.

Aggressive capex plans

New vehicle and cab assembly facility at Uttaranchal to be commissioned in Q1FY08

ALL has planned a Rs 40bn capacity expansion programme over the next three to four years. The company plans to spend Rs 12bn to set up a vehicle and cab assembly facility at Uttaranchal with an annual capacity of 25,000 units. The Uttaranchal plant is expected to be commissioned during the current quarter. This plant will enjoy excise duty exemption and income tax concession for five/ten years.

Besides this, ALL plans to increase the vehicle capacity at its existing plant from 90,000 units per annum to 100,000 units by end-FY08. Further, the company will commission an engine assembly plant (50,000 units/annum) by September 2007 and a gear box assembly facility (50,000 units/annum) by March 2008 at Ennore. It will also spend a part of the capex towards the restructuring of Avia and setting up of a bus assembly plant in the UAE.

Financial review and outlook

Q4FY07: Estimated v/s actual performance

(Rs bn)	Actual	Estimated	% Variance
Net sales	22.9	23.2	(1.3)
EBIDTA	2.6	2.5	6.0
EBIDTA margin (%)	11.6	10.7	-
PAT	1.7	1.5	14.3
PAT margin (%)	7.5	6.5	-
EPS (Rs)	1.3	1.1	14.3

Source: Company, Religare Research

Q4FY07 results

(Rs bn)	Q4FY07	Q4FY06	% Chg YoY	Q3FY07	% Chg QoQ
Sales	22.9	17.3	32.1	17.8	28.9
Realisation/ vehicle (Rs)	876,196.9	850,313.7	3.0	886,534.8	(1.2)
EBITDA	2.6	2.2	22.3	1.8	43.9
EBITDA margin (%)	11.6	12.5	-	10.4	-
PAT	1.7	1.3	27.1	1.1	63.0
PAT margin (%)	7.5	7.8	-	5.9	-
EPS (Rs)	1.3	1.1	17.3	0.8	62.9
Cash EPS (Rs)	1.7	1.4	20.7	1.0	58.5
Core EPS (Rs)	1.2	1.0	15.1	0.7	56.3

Source: Company

Sales grew in line with our estimates

ALL's revenue grew by a robust 32% YoY during Q4FY07. The growth was aided by 28% volume growth and a better product mix resulting in a 3% improvement in realisation. The goods carrier segment contributed a bulk of the sales with a robust 30% YoY increase, while sales of the passenger carrier segment increased 26% YoY.

Positive surprise on EBITDA margin

EBITDA margin improved 120bps QoQ to 11.6% against our estimated 10.7%

The company's EBITDA margin improved 120bps QoQ, while declining 90bps YoY to 11.6% against our estimated 10.7%. The year-on-year drop is attributed to a steep rise in the raw material cost. During the year, the company effected two price hikes which were just about enough to offset the impact of the high raw material prices.

PAT increased by 27% YoY

ALL's reported net profit has increased by 27% YoY and 63% QoQ to Rs 1.7bn in Q4FY07. This translates into an EPS of Rs 1.3 as against our estimated EPS of Rs 1.1.

Expect a revenue CAGR of 13% over FY07-FY09

We expect ALL's earnings to grow at a CAGR of 11% over FY07-FY09, aided by 13% revenue growth and a 60bps EBITDA margin expansion.

Valuation

DCF methodology yields fair value of Rs 48

We have valued ALL's business at Rs 48/share, assuming a weighted average cost of capital (WACC) of 14% and a terminal growth of 3% and a beta 0f 1.1.

DCF assumptions

Particulars	
Beta	1.1
Risk free rate (%)	8.0
Market risk premium (%)	7.0
Cost of equity (%)	16.8
Cost of debt (%)	9.2
Cost of capital (%)	14.3
Terminal growth rate (%)	3.0

Source: Religare Research

Potential upside of 33%; Recommend Buy

Recommend Buy with a DCF target of Rs 48

The stock is currently trading at a P/E of 9.4x, P/CEPS of 7x and EV/EBITDA of 6.7x on FY08 estimates. We believe the stock has a potential upside of 33% from the current level. We therefore recommend a Buy on ALL with a one-year target price of Rs 48. At the target price, the stock will discount FY08 earnings by 12.6x, which we believe is justified.

Financials

Profit and Loss statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Revenues	53.3	71.7	81.5	91.5
Growth (%)	25.5	34.5	13.7	12.3
EBITDA	5.3	7.0	8.2	9.5
Growth (%)	28.6	32.2	17.3	15.4
Depreciation	1.3	1.5	1.8	2.6
EBIT	4.1	5.5	6.5	6.9
Growth (%)	33.4	36.1	17.3	6.9
Interest	0.4	0.1	0.2	0.3
Other income	0.9	0.7	0.7	0.8
EBT	4.5	6.2	7.0	7.4
Growth (%)	27.4	36.6	13.9	5.1
Tax	1.2	1.6	2.0	1.9
Effective tax rate	27.6	26.4	28.0	26.0
Adj net income	3.0	4.4	5.1	5.5
Growth (%)	20.7	45.9	14.8	8.1
Shares outstanding (mn)	1,221.6	1,323.9	1,323.9	1,323.9
FDEPS (Rs)	2.5	3.3	3.8	4.1
DPS (Rs)	1.2	1.2	1.3	1.5
CEPS (Rs)	3.5	4.5	5.2	6.1

Source: Company, Religare Research

Balance sheet

(Rs bn)	FY06	FY07	FY08E	FY09E
Cash and cash eq	6.0	0.8	0.2	0.9
Accounts receivable	4.2	5.8	5.4	7.5
Inventories	9.0	8.1	10.6	11.1
Others current assets	3.0	9.9	11.2	12.6
Current assets	22.3	24.5	27.4	32.2
LT investments	3.7	3.7	3.7	3.7
Net fixed assets	9.4	10.9	18.2	25.6
CWIP	1.4	1.4	1.4	1.4
Total assets	36.9	40.5	50.6	62.9
Payables	10.5	14.5	13.1	13.0
Others	3.6	4.4	8.3	12.4
Current liabilities	14.1	18.9	21.4	25.4
LT debt	6.9	3.0	7.5	12.5
Other liabilities	1.8	1.8	1.8	1.8
Equity capital	1.2	1.3	1.3	1.3
Reserves	12.9	15.5	18.7	22.0
Net Worth	14.1	16.8	20.0	23.2
Total liabilities	36.9	40.5	50.6	62.9
BVPS (Rs)	11.5	12.7	15.1	17.5

Source: Company, Religare Research

Cash flow statement

(Rs bn)	FY06	FY07	FY08E	FY09E
Net income	3.3	4.5	5.1	5.5
Depreciation	1.3	1.5	1.8	2.6
Other adjustments	(1.1)	(0.2)	0.0	0.0
Changes in WC	(0.3)	(2.6)	(1.0)	(0.1)
Operating cash flow	3.2	3.3	5.8	7.9
Capital expenditure	(1.9)	(3.0)	(9.0)	(10.0)
Investments	(1.4)	0.0	0.0	0.0
Other investing inc/(exp)	2.0	0.0	0.0	0.0
Investing cash flow	(1.3)	(3.0)	(9.0)	(10.0)
Free cash flow	1.9	0.3	(3.2)	(2.1)
Issue of equity	0.0	0.1	0.0	0.0
Issue/repay debt	(1.9)	(3.9)	4.5	5.0
Dividends paid	(1.6)	(1.8)	(1.9)	(2.2)
Others	(0.3)	0.0	0.0	0.0
Financing cash flow	(3.8)	(5.6)	2.6	2.8
Beg. cash & cash eq	8.0	6.0	0.8	0.2
Chg in cash & cash eq	(1.9)	(5.3)	(0.5)	0.7
Closing cash & cash eq	6.0	0.8	0.2	0.9

Source: Company, Religare Research

Financial ratios

	FY06	FY07	FY08E	FY09E
EBITDA margin (%)	10.0	9.8	10.1	10.4
EBIT margin (%)	7.6	7.7	7.9	7.6
Net profit margin (%)	5.7	6.2	6.2	6.0
EPS growth (%)	17.6	34.6	14.8	8.1
Receivables (days)	30.2	25.5	24.9	25.7
Inventory (days)	70.0	58.4	56.2	58.3
Payables (days)	90.8	85.3	83.4	70.1
Current ratio (x)	1.6	1.3	1.3	1.3
Interest coverage (x)	10.6	103.5	34.6	22.2
Debt/equity ratio (x)	0.5	0.2	0.4	0.5
ROE (%)	23.7	28.6	27.6	25.3
ROCE (%)	19.9	27.2	27.5	22.1
ROAE (%)	19.7	27.1	27.4	21.9
EV/Sales (x)	0.8	0.7	0.7	0.6
EV/EBITDA (x)	8.4	7.1	6.7	6.2
P/E (x)	14.5	10.8	9.4	8.7
P/BV (x)	3.1	2.8	2.4	2.1
P/CEPS (x)	10.3	8.1	7.0	5.9

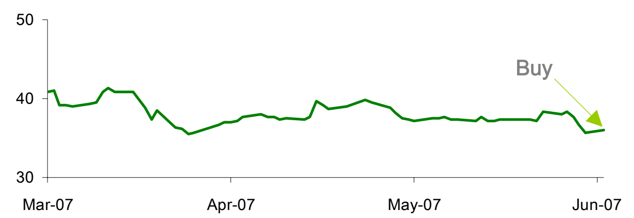
Source: Company, Religare Research

Recommendation history

Date	Event	Target (Rs)	Reco
14-Jun-07	Company Update	48	Buy

Source: Religare Research

Stock performance



Source: Religare Research

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