Company Flash

7 May 2007 | 8 pages

Ashok Leyland (ASOK.BO)

Sell: 4Q Results – Strong Results, Healthy Guidance

- **Positive surprise** — Pre-exceptional profit rose 29% yoy (24% above our estimate), driven by a stronger-than-expected EBITDA margin. Lower interest and tax, and higher other income offset the weakness in operating margin.
- **Margins decline, but above expectations** — EBITDA margins declined by ~100bps to 11.3% (vs. our estimate of 10%). Staff costs increased due to one-time VRS expenses. Realizations improved marginally by 3.7% yoy due to a higher share of heavy trucks in the product portfolio.
- **Conference Call highlights** — Management has guided to c10% growth in FY08 CV volumes (MHCVs - 10-12%, Buses - 5-6%). Margin guidance remains hazy, but margins are expected to remain largely range-bound. Significantly, management indicated that while cost pressures will continue, it will not hike prices beyond the Rs10k increase undertaken in Apr 2007.
- **Capital outlay estimates revised up** — Management expects to incur Rs14bn capex (expansion: Rs10bn, Investments in subsidiaries: Rs4bn) in FY08. Around 54% of the total capex will be used for expansion of Uttaranchal (~Rs4bn) and Ennore (~Rs3.5bn) facilities. Management targets total capacities at 184,000 units in FY10 (vs. 100,000 units currently).
- **Reiterate Sell/Low Risk** — Although we see limited downside from current levels, supported by dividend yield, the absence of upside triggers means the stock could remain range-bound, in our view. Key upside risks: sharper-than-expected margin expansion and stronger-than-forecast volume growth.

Sell/Low Risk	**3L**
Price (07 May 07)	Rs38.85
Target price	Rs39.00
Expected share price return	0.4%
Expected dividend yield	3.9%
Expected total return	**4.2%**
Market Cap	Rs51,432M
	US$1,265M

Statistical Abstract

Year to 31 Mar	Net Profit (RsM)	Diluted EPS (Rs)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2005A	2,453	1.86	10.4	20.9	4.0	22.1	2.3
2006A	3,094	2.32	25.1	16.7	3.4	24.0	3.1
2007E	3,992	3.00	29.0	13.0	2.7	24.0	3.9
2008E	4,490	3.37	12.5	11.5	2.5	22.3	4.4
2009E	5,210	3.91	16.0	9.9	2.2	23.5	5.1

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification and important disclosures.

[1]Citigroup Global Market India Private Limited

Figure 1. 4Q FY07 — Operational Data

	4QFY06	4QFY07	% chg YoY	CIR Comments
Volumes (Nos.)				
H / MCVs	20,171	26,084	29.3	Strong volume growth led by multi axle segment
LCVs	202	46	-77.2	
Total CVs	**20,373**	**26,130**	**28.3**	
Market share (%)				
H / MCVs	30.1	31.5		
LCVs	0.4	0.1		

Source: Company Reports, Citigroup Investment Research

Figure 2. 4Q FY07 — Financial Data

(INR m)	4QFY06	4QFY07	% chg YoY	CIR Comments
Gross Sales	20,034	26,647	33.0	
Less: Excise duty	2,686	3,737	39.2	
Net sales	**17,348**	**22,910**	**32.1**	Driven by strong volume growth and superior product mix, in line with our estimates
Raw Materials	12,838	17,059	32.9	Lower than our forecasts
Staff costs	816	1,163	42.6	Higher due to one-time VRS expense
Other Expenses	1,554	2,092	34.6	
Total Expenditure	15,207	20,314	33.6	
EBITDA	**2,141**	**2,596**	**21.2**	OPM declines by 101bps vs. our expectation of 257bps
Foreign Exchange Gain / Loss	-46	-54	16.8	
Interest	98	19	-80.8	Sharp reduction in working capital beneficially impacts interest costs
Other income	110	169	53.4	
EBDT	2,199	2,800	27.3	
Depreciation & Amortization	330	481	45.7	Substantially higher than forecast
PBT	1,869	2,318	24.1	
Exceptional expenditure	-21	-30	46.0	
Tax	513	573	11.6	
PAT	1,335	1,715	28.5	
PAT (pre exceptionals)	**1,350**	**1,738**	**28.8**	**24% above our estimates**
Profit Margins (%)				
EBITDA (%) net sales	12.3	11.3		
EBIT (%)	9.0	7.9		
EBDT (%)	11.0	10.5		
Tax / PBT (%)	27.8	25.0		
Net profit margins (%)	6.7	6.5		
Cost ratios				
Raw materials / sales	74.0	74.5		
Staff costs / sales	4.7	5.1		
Other expenses / sales	9.0	9.1		

Source: Company Reports, Citigroup Investment Research

Figure 3. April 2007 Sales

	Apr-07 Nos	% chg YoY	% chg over Mar 07
MDV passenger	1,332	127.7	-20.2
MDV goods	4,493	1.3	-33.6
LCV	24	41.2	
Total	**5,849**	**16.1**	**-30.7**
Domestic	**5,487**	**15.5**	**-30.8**
Exports	**362**	**25.3**	**-28.7**

Source: Company

April sales report healthy growth, driven by exceptionally strong one-off growth in buses. Goods sales rose marginally, as the strong growth in multi-axle vehicles and tractor-trailers offset weakness in the 10-16MT category.

Ashok Leyland

Company description

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 thesis

We have a Sell/Low Risk rating on ALL — valuations being the primary concern. We believe the stock currently prices in all positives. Fundamentally, key reasons for a healthy growth outlook in commercial vehicles include a sustained pick-up in economic activity, a focus on infrastructure spending and a strong replacement cycle (27% 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. ALL is raising capacity by c30% over the next two years to meet demand, and plans to launch new products. In the long term, exports could emerge as a growth driver as ALL leverages off its low-cost competitive advantage to enter foreign markets.

Valuation

Our 12-month target price of Rs39 for ALL is based on 8.55x FY08E cash earnings. Our target multiple is at a 20% discount to the multiple we assign to Tata Motors (TAMO.BO - Rs727.95; 1L), which we believe, correctly reflects ALL's substantially smaller scale of operations and less diversified revenue profile. (ALL is not present in passenger cars or utility vehicles and has an extremely modest presence in light commercial vehicles.) A c18% CAGR in cash earnings over FY06-08E should support these valuations. We prefer to use P/CEPS as a valuation metric to ensure proper comparison with historical trading bands, a restructuring of the balance sheet in FY03 and the capital-intensive nature of the business. At our target price, the stock would trade at a

P/E of 13x FY07E EPS, in the middle of its recent trading band. This is well supported by a 20% CAGR in earnings over FY06-08E.

Risks

We rate ALL Low Risk based on our quantitative risk rating system, which tracks 260-day historical share price volatility. 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 is 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) Reduction in input costs (notably steel and aluminium) would benefit earnings; 3) Effective integration of the Avia acquisition could enable ALL to successfully penetrate the domestic LCV market.

Tata Motors

Valuation

Our 12-month target price of Rs1,029 is based on a sum-of-parts valuation methodology, which we believe captures the value embedded in subsidiaries and group holdings. Management has indicated its intent to unlock value, (to the benefit of Tamo's existing shareholders), for either / both HV Transmissions Ltd. and HV Axles Ltd., through an IPO or strategic sale to outside parties.
We value Tata Motors' core business at Rs 827 / share, which is based on 9.2x FY08E EBITDA, at the lower end of the recent trading band, and which should be comfortably supported by a 25% CAGR in EBITDA over FY06-08E. Over the past fiscal, the EV / EBITDA multiple has ranged between 6.2-11.4x. We value the subsidiaries at Rs201 / share.

Risks

We rate Tata Motors Low Risk based on our quantitative risk rating system, which tracks 260-day historical share price volatility. Key downside risks to our target price are movements in economic variables — particularly GDP growth, interest rates and fuel prices, to which sales of commercial and passenger vehicles are very sensitive. Competition in the passenger car business remains intense with the presence of most global majors in the Indian market. While the commercial vehicle business has been relatively less exposed to competition, the situation could change over the next three years with international companies eyeing the Indian market. Key upside risks to our target price include: a) Strategic sale/IPO of key subsidiaries; b) An indication that the Supreme Court ruling on overloading is being implemented over the longer term; and c) Reduction in input costs (notably steel).

Appendix A-1

Analyst Certification

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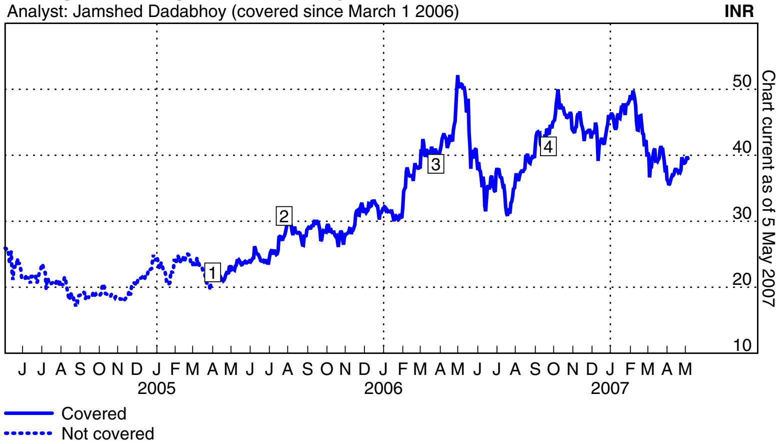
Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoy (covered since March 1 2006)



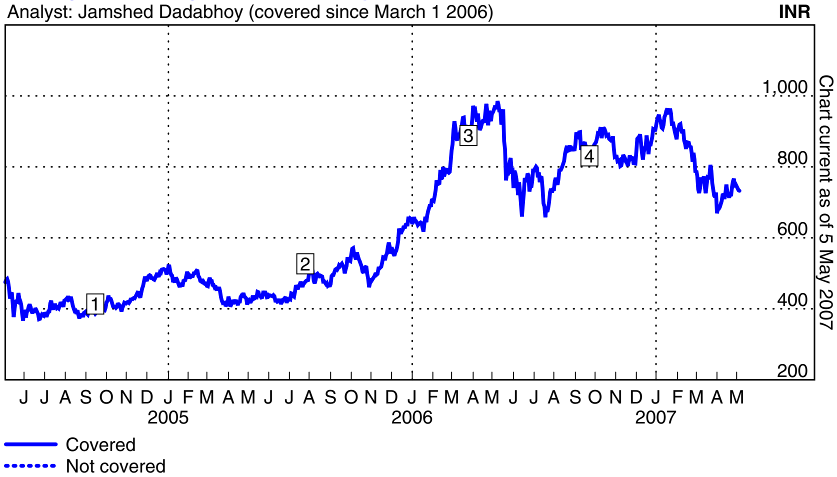
#	Date	Rating	Target Price	Closing Price
1:	1 Apr 05	1M	26.00	21.70
2:	26 Jul 05	*1L	*31.00	27.75
3:	26 Mar 06	*3L	*37.00	40.75
4:	22 Sep 06	3L	*39.00	43.30

*Indicates change.

Tata Motors (TAMO.BO)

Ratings and Target Price History - Fundamental Research

Analyst: Jamshed Dadabhoy (covered since March 1 2006)



#	Date	Rating	Target Price	Closing Price
1:	15 Sep 04	*1M	675.00	385.95
2:	26 Jul 05	*1L	*656.00	476.50
3:	27 Mar 06	*2L	*974.00	901.35
4:	22 Sep 06	*1L	*1,029.00	835.45

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