Equity Research
March 30, 2012
BSE Sensex: 17404

Automobiles

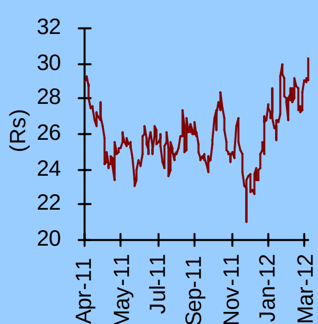
Target price Rs32

Shareholding pattern

	Jun '11	Sep '11	Dec '11
Promoters	44.6	44.6	44.6
Institutional investors	34.8	36.5	36.3
MFs and UTI	4.8	3.5	3.8
FIs/Banks	14.2	14.1	14.3
FIIs	15.6	18.7	18
Others	0.15	0.15	0.15

Source: NSE

Price chart



Sanket Maheshwari
sanket.maheshwari@icicisecurities.com
+91 22 6637 7159
Vijit Jain
vijit.jain@icicisecurities.com
+91 22 6637 7265

INDIA

Ashok Leyland

ADD

Hardwired to the infrastructure story

Rs30

Reason for report: Initiating coverage

With a heritage of over six decades, Ashok Leyland (ALL) is the only listed pureplay commercial vehicle (CV) manufacturer in India. We are broadly affirmative on the stock, although we do have concerns. Our positive view is based on: a) EBITDA margins that appear to have bottomed out, and b) a long-term trend pointing at the CV industry's shift towards high-end trucks, which is ALL's forte. Our concerns arise from: a) the company's dependence on core infrastructure sectors, which makes near-term volume growth vulnerable, b) increasing competition, which will limit ALL's pricing power. We expect ALL's EPS to grow from ~Rs2.0 in FY12 to Rs2.2/Rs3.1 in FY13/FY14 owing to sales of ~Rs134bn/Rs152bn, and EBITDA margins of 10.1%/10.9% in FY13/14 respectively. We value ALL at Rs32 (7x FY13-14 average EBITDA, and Rs3/share for its key joint ventures). Initiate with ADD.

- **Mild concerns on volume growth…** Around 70% of ALL's volumes come from the 12te+ trucks, which depend on the country's core infrastructure sectors – construction, mining, etc. With question marks on most of these sectors for FY13, we expect ALL's ex-*Dost* FY13 volumes to grow 5% *vs* (-3%)/54% in FY12/FY11. Geographically, ~50% of ALL's volumes come from South India and the company has 48% market share in that region *vs* ~21% pan-India share. There are signals that core industry growth has started recovering in the South but we believe a proper growth in ALL's volumes will only come in FY14.
- **…though margins may have bottomed out.** We believe EBITDA margins bottomed out in Q3FY12 and may improve hereon – from 9.9% in FY12E to 10.1%/10.9% in FY13/FY14E. The impact of discounts plus the lower margin of sub-3.5te *Dost* SCVs, will be more than compensated by flattish commodity prices and benefits from the Pantnagar plant. Because ALL is exempt from excise duty at Pantnagar, post Budget 2012 hike in excise duties by 2%, ALL's savings from that plant increase by ~Rs17,674/vehicle
- **Intense competition will constrain pricing power:** ALL lost 4% market share in the past one year and future years will see an increase in competitive intensity. ALL is more dependent on transporters in the organised sector – a segment that will be strongly targeted by global majors like Daimler and Volvo (through JV with Eicher). Moreover, players like Asia Motor Works (AMW) are getting more aggressive. Thus, discounts of ~3% introduced in Jan'12 will most likely continue through FY13, limiting margin upside.
- **The only pureplay CV stock; initiate with ADD:** ALL is the only pureplay CV manufacturer among listed companies. The industry is undergoing a structural change by way of increasing preference for larger trucks which will benefit ALL but, on the flip side, competition is increasing. We value ALL's core business at 7x FY13-14E average EBITDA – translating into Rs29/share – and investments in JVs at Rs3/share. Initiate with **ADD**.

Market Cap	Rs79.8 bn/US$1.6 bn
Reuters/Bloomberg	ASOK.BO/AL IN
Shares Outstanding (mn)	266
52-week Range (Rs)	30/21
Free Float (%)	55.4
FII (%)	18.0
Daily Volume (US$/'000)	3,357
Absolute Return 3m (%)	30.4
Absolute Return 12m (%)	(47.2)
Sensex Return 3m (%)	12.2
Sensex Return 12m (%)	(10.5)

Year to Mar	FY11	FY12E	FY13E	FY14E
Revenue (Rs mn)	111,177	123,447	134,417	152,080
Rec. Net Income (Rs mn)	6,313	5,235	5,794	8,153
EPS (Rs)	2.4	2.0	2.2	3.1
% Chg YoY	64.2	(16.9)	10.7	40.7
P/E (x)	12.8	15.4	13.9	9.9
CEPS (Rs)	3.4	3.3	3.7	4.6
EV/E (x)	8.9	9.5	8.4	6.5
Dividend Yield (%)	3.3	2.5	2.8	3.9
RoCE (%)	14.5	11.3	11.4	14.3
RoE (%)	25.3	18.7	18.7	23.4

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Investment argument

Table 1: Key Assumptions

	FY11	FY12E	FY13E	FY14E
Unit sales	93,406	100,733	127,258	139,787
Domestic	83,100	80,064	83,192	91,315
Exports	10,306	12,787	14,066	15,472
Dost	0	7,882	30,000	33,000
Net realisation/vehicle (ex-*Dost*) (Rs)	1,051,196	1,155,414	1,151,838	1,179,923
Net realisation/vehicle (*Dost*) (Rs)		252,000	249,934	256,071
Total operating income (Rs mn)	111,177	123,447	134,417	152,080
Gross margins	26.9%	26.7%	26.9%	26.8%
EBITDA (Rs mn)	12,176	12,190	13,559	16,542
EBITDA Margin	11.0%	9.9%	10.1%	10.9%
PAT (Rs mn)	6,313	5,235	5,794	8,153
EPS (Rs)	2.4	2.0	2.2	3.1

Source: Company data, SIAM, I-Sec research

Valuations commensurate with risks; initiate with **ADD**

We value ALL at 7x FY13-14E average EBITDA, at a discount to its long-term average EV/EBITDA multiple of 8x taking into view increasing competition in the heavy commercial vehicle (CV) market in India and lower growth as compared to peers like Eicher. We also note that ~Rs1.9bn or 14% of ALL's FY13E EBITDA will come from excise benefits which will start reducing FY15 onwards because of excise regulations under which the Pantnagar plant operates.

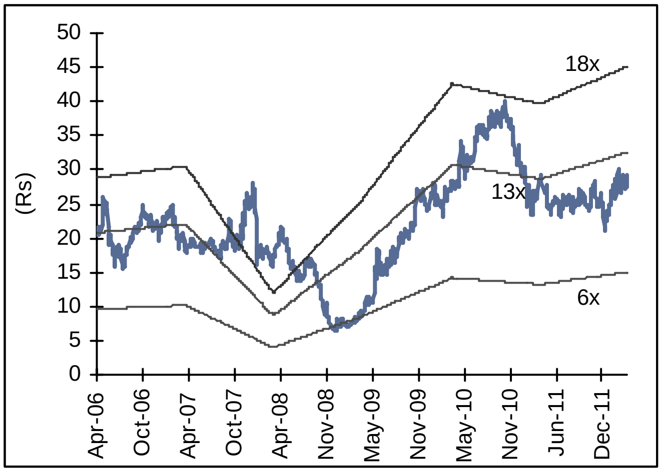
We value ALL's core business at Rs29/share and value its investments in various joint ventures at book value of Rs3/share. We initiate with an **ADD** rating with a target price of Rs32/share. Our target price implies 12x FY13-14E average EPS, which is also below long-term average P/E (13x) for the company.

Table 2: Valuation Table

	Value (Rs mn)	Per share (Rs)
FY13-14 EBITDA average	15,051	6
Multiple (x)	7	7
EV	105,355	40
Average Net Debt	27,871	10
Value	77,484	29
Investments	8,693	3
of which ALL-Nissan	*6,688*	
of which ALL-John Deere	*2,005*	
Total equity value	**86,177**	**32**

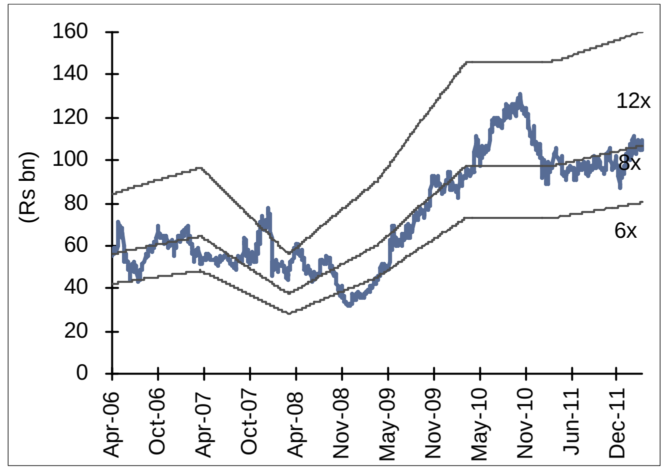
Source: Company data, SIAM, I-Sec research

Chart 1: P/E band chart



Source: Bloomberg, I-Sec research

Chart 2: EV/EBITDA band chart



Source: Bloomberg, I-Sec research

Key risks

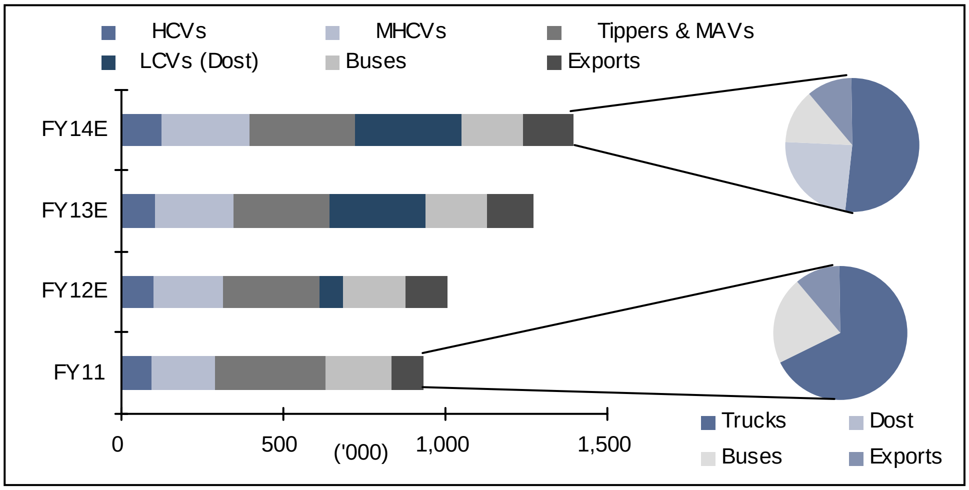
Volume growth

Strong pick-up in infrastructure growth will likely change our volume projections for FY13. We currently expect slow to medium growth.

Mild concerns on volume growth

In FY12, ALL's ex-*Dost* domestic volumes will most likely decline by 4% to 80,000 vehicles (61,000 trucks, 19,000 buses). Further, we think growth in FY13 will be marginal at best, at 4%. Our concerns arise from a host of issues: a) mining may not stage a strong recovery in FY13, b) pace of infrastructure growth may remain subdued, and c) diesel price hike (9%) and interest rate hikes (175bps) in the past year have increased transport operators' business costs, despite which freight rates have remained stable. However, these concerns stand marginally alleviated by the possibility of ALL exploiting replacement demand particularly in North India, and signals that South India may see some pick-up in demand.

Chart 3: Ex-*Dost* significant volume growth not seen until FY14



Source: Company data, SIAM, I-Sec research

Table 3: Change of 1% in volume affects FY13E EBITDA 2.5% & EPS 4%

(Rs mn)

	FY13E	+5% sales	FY14E	+5% sales
Operating Income	**100.0**	**105.0**	**100.0**	**105.0**
% chg		*5*		*5*
Fixed costs	13.8	13.8	13.0	13.0
Variable costs	76.1	79.9	76.1	79.9
EBITDA	**10.1**	**11.3**	**10.9**	**12.1**
% chg		*12*		*11*
Net other expenses (income)	4.6	4.6	3.9	3.9
Tax	1.2	1.5	1.6	1.9
PAT	**4.3**	**5.2**	**5.4**	**6.3**
% chg		*22*		*17*

Source: Company data, I-Sec research
Note: The figures are normalised on a scale of 100.

Infrastructure growth pace restrains ALL's volume outlook

M&HCVs (12te+) have always been hardwired to India's infrastructure and economic growth. A significant portion (70%) of ALL's sales comes from trucks in the 12te+ GWT range. In fact, ~54% of the company's unit sales come from Tippers and MAVs (GWT 16te+) – vehicle types used mostly in infrastructure (mostly construction and mining) and long-haul transportation.

Table 4: ALL's tonnage-wise market share in CV segments

SIAM Classification	Truck types	Applications	Industry proportion (%)*	ALL's market share (%)	5-year segment CAGR (%)	Outlook Comment
<7.5te	LCVs & SCVs	Intra-city goods transport	51	NM	21	The fastest growing segment – ALL has recently introduced a model *Dost* in this segment
>7.5te & <12te	ICVs	Intra-city distribution, agri-perishables, inter-city distribution	8	6	11	
<16.2te	MCVs	Parcels and white goods, Tankers, market loads	8	28	0	Cautious outlook
>16.2te & <25te	MCVs, tippers and MAVs	Mining applications, construction, roadwork, materials and port transport	10	22	17	Cautious outlook
>25te	Tippers and MAVs	Mining applications, construction, roadwork, materials and port transport	8	23	5	Near term cautious, long term positive
TTs: >26te & <35te	Tractor trailers	Containers, cement, steel, car carriers	1	NM	10	
TTs: >35.2te	Tractor trailers	Containers, cement, steel, car carriers	2	22	32	
Total trucks			**88**	**9**	**15**	

*Proportion is based on FY12 YTD numbers
Source: Company data, SIAM, I-Sec research
LCVs: Light commercial vehicles; SCVs: Small commercial vehicles; ICVs: Intermediate commercial vehicles

Table 5: Core sectors of the economy have not been doing well

(%)

Sector	9M FY12	9M FY11
Agriculture	3.2	6.8
Mining	(1.4)	6.7
Manufacturing	3.4	7.6
Electricity	8.7	2.3
Construction	4.2	7.7
Others	9.4	8.9

Source: RBI, GoI, I-Sec research

Chart 4: Index of Industrial Production (IIP) hasn't shown sustained pick-up since Jun'11

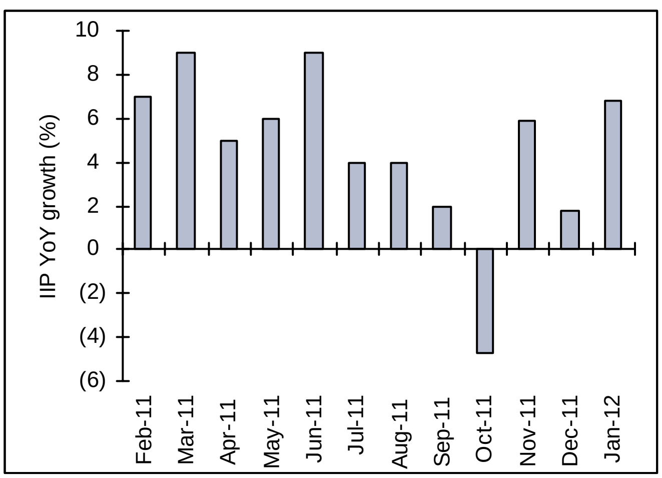
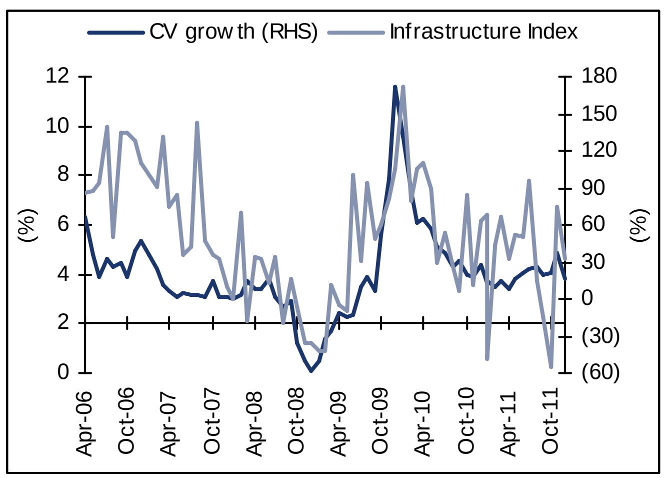


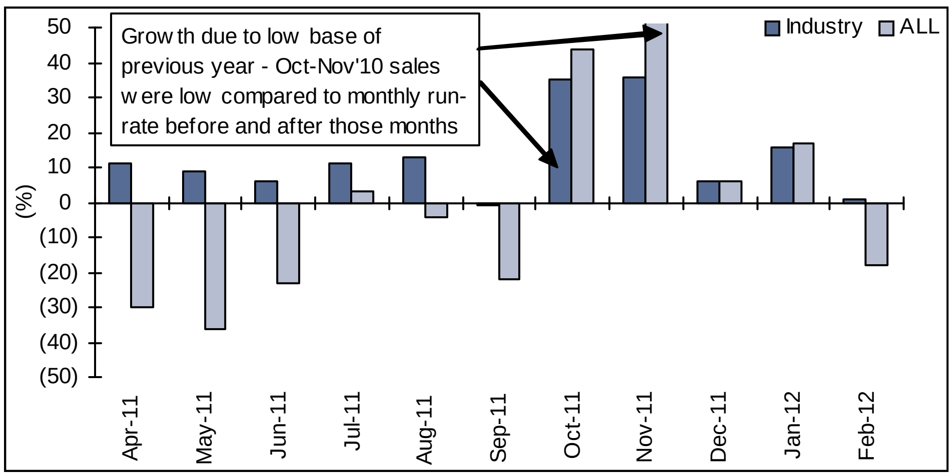
Chart 5: CV sales closely track infrastructure growth



Source: RBI, Bloomberg, I-Sec research

We are cautious on near-term growth prospects for core infrastructure sectors as the constraints may not just be arising from the high interest rates prevalent. In mining sector for example, Iron-ore mining in Karnataka was shutdown last year due to environmental issues and Supreme Court orders. Our mining analyst believes that, in the best case scenario, some of the iron ore mines may be re-opened in FY13, but the Supreme Court has capped the state's iron ore production to 30mnte *vs* its actual production of 45mnte in FY11. In Goa, the M.B. Shah Committee was instituted to conduct an enquiry into allegations of illegal mining in the state – the final report is due soon – and the newly elected government has promised to crackdown on illegal mining and impose stricter licensing regulations. The mining sector has registered a 1.5% decline in FY12 YTD following 5% growth recorded in FY11. If these issues spread to other mining-centric states like Odisha, further decline may be seen. Although tippers have more widespread usage than mining, the latter is a key consumer of tippers and South India (the ban has been imposed in Karnataka – a South Indian state) is an ALL stronghold; these concerns have a direct bearing on ALL's tipper sales in South India.

Chart 6: Growth in tippers and MAVs – Industry-wide *vs* ALL



Source: SIAM, I-Sec research

Channel checks caution on freight haulage as well, till H1FY13

Growth in freight closely follows the GDP curve by a factor of 1.1x, and port traffic growth, which has significant impact on demand for long-haul tractor trailers (TT) and Multi-Axle Vehicles (MAV). With a pronounced slowdown in GDP growth rate and port-traffic dependent on an erratic global economy, many transport operators have turned cautious on freight haulage prospects at least until end of H1FY13 – our discussions with a North India-based freight operator has revealed. We have also learnt from our interactions that:

- Operators were not able to pass on diesel price and interest rate hikes (of 9% and 175bps respectively); freight rates therefore have remained steady in the past one year.
- Many operators formally increased rates, but also started offering high discounts.
- Some operators purchased trucks in FY12 as certain state governments clamped down on overloading. These operators are unlikely to buy trucks in FY13 as per-truck utilisation levels have dropped.

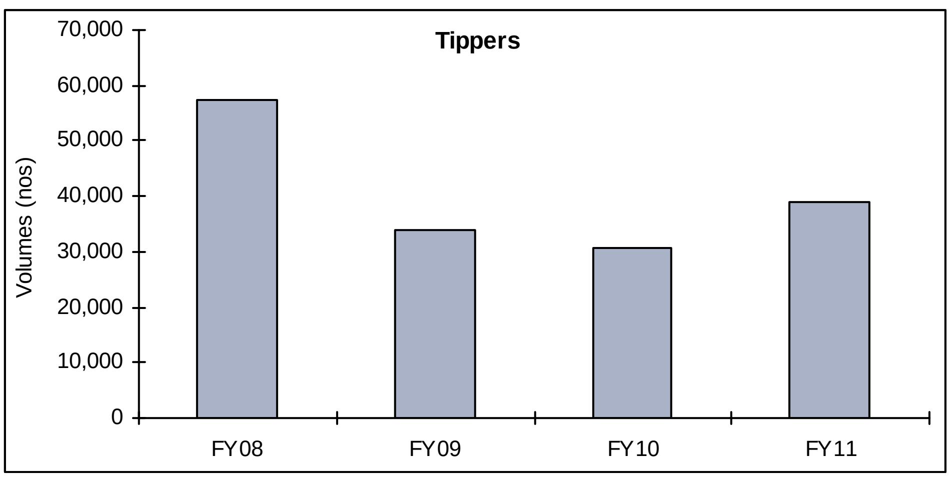
Bus sales may remain sluggish

In the bus segment, which accounts for 25% of ALL's volumes, the Jawaharlal Nehru National Urban Renewal Mission (JNNURM) lent a major growth fillip to bus sales in FY10 and FY11. The government allocated Rs 880mn for the next phase of the project in Union Budget 2012. However, the implementation of the next phase of the plan has to be decided by the Planning Commission which will take time, therefore we expect growth in the bus segment to stay flat – with private bus sales offsetting declining orders from state transportation units.

There is a silver lining, though

The ALL management as well as our own channel checks reveal a strong replacement demand – especially for tippers, which (owing to heavy usage) have a replacement cycle of four to five years, and FY08-FY09 saw peak volumes in the tipper segment. We believe if ALL is able to increase penetration in North India, it may benefit from the replacement demand growth. However, tipper demand may remain subdued in South India. Overall, we believe significant growth will not occur until FY14. We expect overall ex-*Dost* truck volumes to grow at 5%/12% in FY13 and FY14 respectively. We expect tippers and medium CVs (7.5te-16te) to grow at 10%/15% over this period and MAVs and TTs to grow at 0%/10%. We expect Bus segment growth to remain flat over FY13/14.

Chart 7: Replacement demand could be stronger in FY13-14E

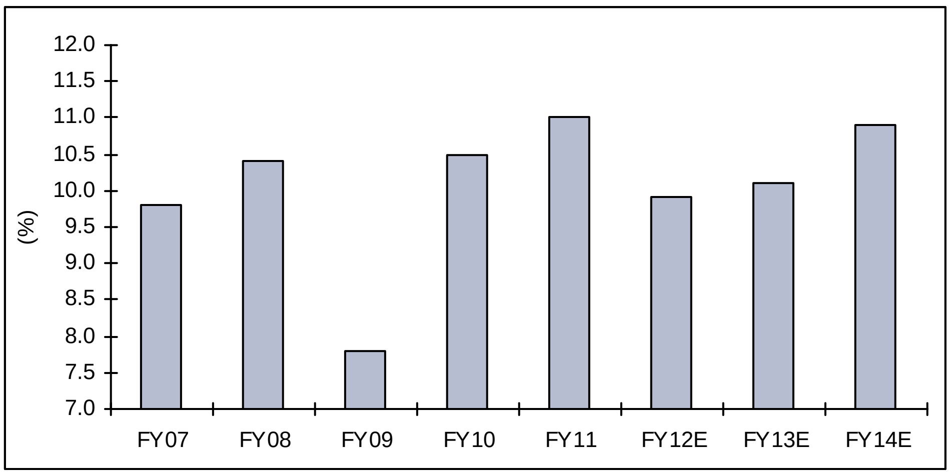


Source: Company data, I-Sec research

One clear positive: Margins have bottomed out

Q3FY12 saw ALL's EBITDA margins declining to 7.3% on account of one-time as well as bundled (all coming in a single quarter) expenses and increasing discounts on selling prices. Thus, future quarters may see normalisation of margins as: a) the company ramps up production from its Pantnagar (Uttarakhand) facility where higher excise benefits post the Union budget add ~46bps to EBITDA margins, and b) better operating leverage, the effects of which will be felt more in FY14 rather than FY13. However, we believe increasing competition will force increase in discounting and prevent significant margin improvements. We expect FY13 EBITDA margin to improve to only 10.1% *vs* 9.9% in FY12 as discounting, which increased to 3-4% in Jan'12, will remain on the higher side, and to 10.9% in FY14.

Chart 8: Pantnagar benefits to EBITDA margins will be significantly offset by increasing discounts



Source: Company data, I-Sec research

Table 6: Impact of discounts on net realisation

(Rs/vehicle)

	Q3FY12	FY13E	FY14E
Previous period net realisation	1,159,578	1,151,838	1,144,902
+Product mix change/Price hikes	2,260	(8,436)	25,022
+Withdrawal (Addition) of discounts	(10,000)	1,500	10,000
Net realisation per vehicle	1,151,838	1,144,902	1,179,923

Source: Company data, I-Sec research

Low EBITDA margin of Q3FY12 was an exception

For ALL, Q3FY12 was an exceptionally low-margin quarter, which we do not believe will recur in our forecast horizon. The 7.3% EBITDA margin reported by the company was 270bps lower than its normal run rate of ~10%. However, we note that a significant portion of decline was owing to special circumstances: a) employee costs increased by ~Rs160mn owing to one-time bonus payments, b) other expenses increased by Rs150mn as warranty expenses of the first three quarters of FY12 were bundled and incurred at one-go in Q3FY12, and c) the company booked Rs150mn losses on restatement of foreign currency loans. In other words, ~Rs460mn of expenses incurred in Q3FY12 can be considered one-time. Increase in discounts was the only structural issue in Q3FY12 – and that is unlikely to go away quickly, so we are factoring continuation of ~3% discounts in our FY13 estimates.

Table 7: Q3 EBITDA margins hurt by one-off factors…

(Rs mn)

	Reported Q3FY12	Recurring Q3FY12	Q4FY12E	FY12E
Total operating income	28,798	28,798	38,518	123,447
Raw material costs	21,288	21,288	28,426	90,452
Employee costs	2,723	2,563	2,820	10,555
Other expenditures	2,683	2,583	3,175	10,251
EBITDA	2,104	2,364	4,098	12,190
EBITDA margin (%)	7.3	8.7	10.6	9.9

Source: Company data, I-Sec research

Increasing production in Pantnagar will help support margins

Assuming ALL increases prices in line with increase in excise duty, the new excise structure will allow ALL to save Rs17,674 incrementally in manufacturing cost per vehicle at its Pantnagar (Uttarakhand) facility, and this we believe will help it sustain margins through FY13 despite high discounts in selling prices. ALL does not have to pay any excise on production at Pantnagar plant till FY14 and that benefit is extended to its vendors located in the Uttarakhand.

Currently 70% of vendors to the Pantnagar plant are located in Uttarakhand (and thus availing of the benefits), the government's excise collection is reduced from ~10% for a normal plant to 2.4%. These savings of ~7.6% is what is shared between ALL and its vendors; if excise duty is increased from 10% to 12% (as in this Union budget), the savings increase by 20%. In addition, if localisation increases from the current 70% to 75%, total savings (including exemption from a higher excise rate) increase by 50%. In the 10% excise regime, ALL was saving ~Rs45,000/vehicle at ~70% localisation levels (actual savings may be lower, at ~Rs35,000/vehicle, as production is lower than what was promised to vendors). Thus, logically, total savings from the Pantnagar plant can increase by ~Rs22,500 with 75% localisation.

However we note:

- Production ramp-up at Pantnagar has not gone according to expectations, so we believe ALL is paying more to the vendors. Thus, rather than factoring a saving of ~Rs45,000/vehicle, we are factoring-in ~Rs35,000/vehicle (at the pre-budget excise rate of 10%).
- We do not believe all the savings in Pantnagar will translate into real savings. We note that even as production from the Pantnagar facility has increased, EBITDA margins have not. This indicates that the savings in Pantnagar are being used to support discounts on *U-Trucks* and defend market share.
- This discounting, visible in Q3FY12, will continue and probably increase in FY13. Thus, ALL's bottomline may improve by only ~Rs17,000/vehicle as the incremental benefits will be used to sustain discounts.
- This translates into an additional EBITDA of Rs636mn for FY13 and Rs848mn for FY14 as production from Pantnagar is increased from 3,000 units to 4,000 units annually through FY13 and FY14.
- Thus, as production increases, logically ALL's savings from Pantnagar can increase to ~Rs67,500/vehicle but we believe ~Rs15,000 benefit will be used to support discounts as well. Thus, total savings for ALL from Pantnagar plant will amount to Rs 52,674/vehicle – of which Rs 35,000/vehicle was already being earned in Q3FY12.

Table 8: Normalised analysis of savings accruing from Pantnagar fiscal benefits

	Q3FY12	New excise	New excise + Increased localisation
Excise duty (%)	10	12	12
Localisation (%)	70	70	75
Price (including excise duty per vehicle)	110	112	112
Net Realization (per vehicle)	**100**	**100**	**100**
Ex-Pantnagar plants			
Excise paid by system (per vehicle)	10	12.00	12
- of which paid by vendors	6.7	8.02	8.02
- of which paid by ALL	3.3	3.98	3.98
Pantnagar plant			
Excise paid by system (per vehicle)	2.00	2.41	2.00
- of which excise paid by localised vendors	0	0	0
- of which excise paid by non-localised vendors	2.00	2.41	2.00
- of which paid by ALL	0	0	0
Total savings from Pantnagar (Vendors + ALL) (per vehicle)	**8.00**	**9.59**	**10.00**
Savings for ALL (Rs/vehicle)	**35,000**	**42,000**	**52,674**
Incremental savings (Rs/vehicle)		7,000	17,674

Source: Company data, I-Sec research

Chart 9: Pantnagar benefits add 140-170bps to EBITDA margin

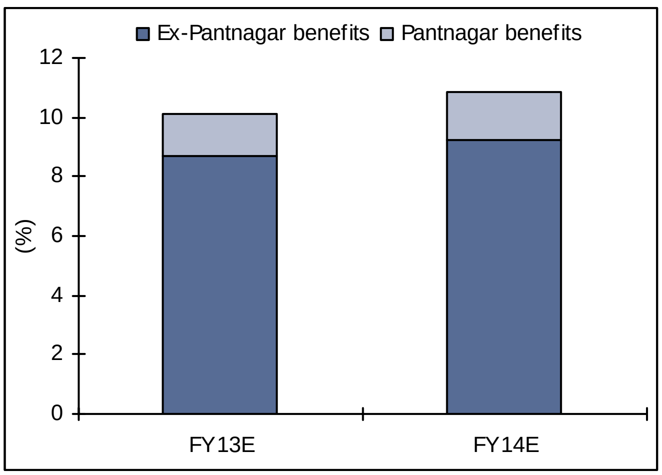
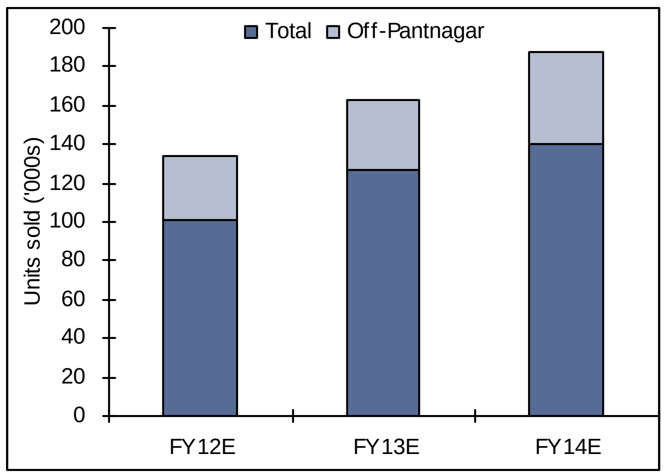


Chart 10: Expect production at Pantnagar ramping up to 4,000 in FY14



Source: Company data, I-Sec research

Dost – Insignificant impact on ALL's margins

Produced by ALL's joint venture with Nissan and commercially launched in Sep'11, the *Dost* LCV has received encouraging response from the market, registering sales of ~1,500 vehicles per month. Given ALL's strong reputation and long history in the Indian market, we expect *Dost* to be at least moderately successful in the LCV segment, which is the fastest growing segment of the domestic CV market even though competitor products such as Tata *Ace* and Mahindra LCVs have had significant headstart.

The Dost earns ~800bps lower gross margins than the other products in ALL's portfolio. However, since net realization/vehicle for the Dost is substantially lower than the other vehicles (at ~Rs 250,000/vehicle versus Rs 1.1mn/vehicle for other vehicles), its overall impact on gross margins of ALL is barely 90bps.

Chart 11: *Dost* will be a key volume growth driver, but…

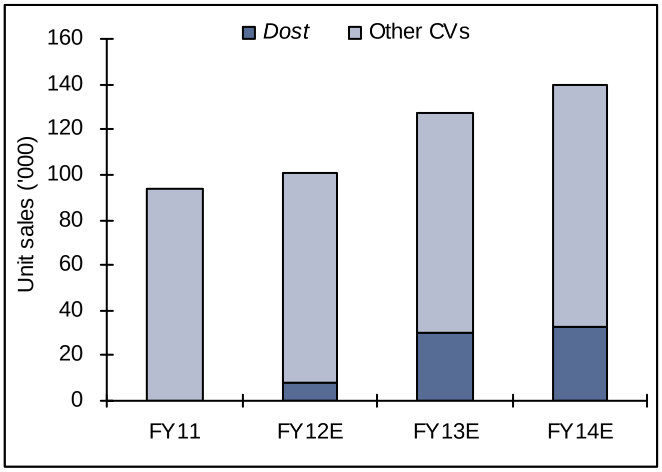
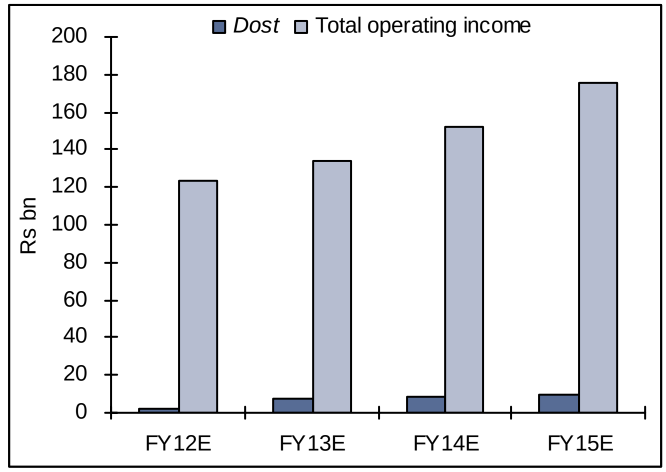


Chart 12: ...will account for only ~4% of ALL's overall operating income

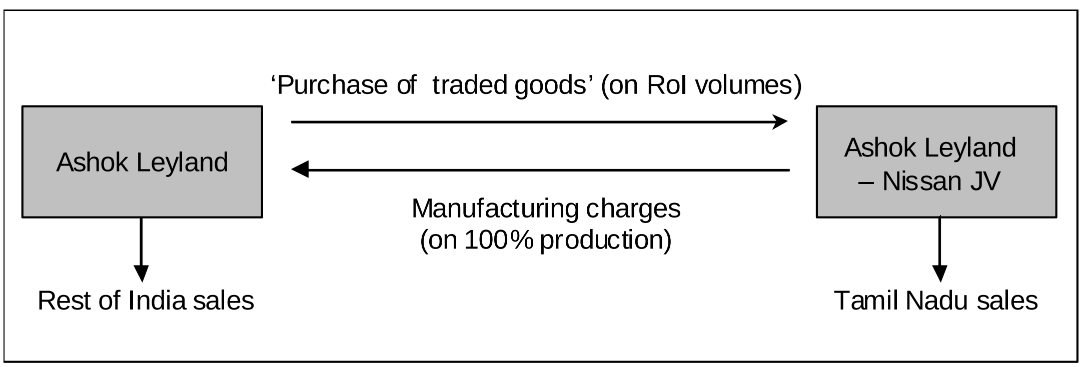


Source: SIAM, Company data and I-Sec research

The *Dost* arrangement

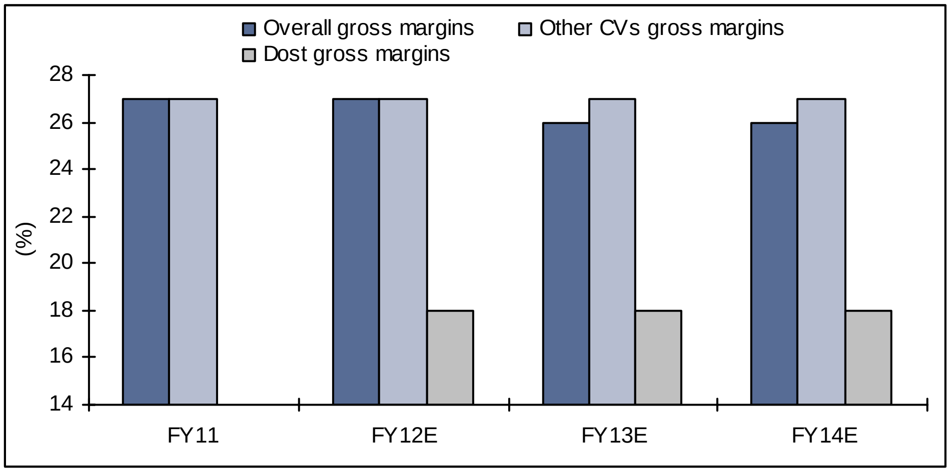
Dost vehicles are currently contract-manufactured by ALL at its premises in Hosur (Karnataka). The joint venture (Ashok Leyland-Nissan Vehicles) sells the vehicles in Tamil Nadu (TN), entitling it to VAT credit from the state government. For sales outside TN, the joint venture sells the vehicles back to ALL, which books the procurement as a raw material expense. The standalone entity therefore collects a 'manufacturing charge' on complete production and a marketing margin on *Dost* sales outside TN. Consequently, standalone entity's margins on the *Dost* are lower as part of the value is retained by the JV (We presently value ALL's stake in JV at book-value of investment).

Chart 13: *Dost* will therefore be a key volume growth driver



Source: Company, I-Sec research

Chart 14: *Dost* margins are ~800bps lower than the normal margins



Source: Company data, I-Sec research

Competition continues to intensify…

Competitive intensity is set to rise in the CV space in India as Tata Motors looks to defend its market share and international majors make aggressive investments and deploy diverse entry strategies – Volvo and Navistar in tie-ups with local brands Eicher and M&M respectively, Daimler Benz in a solo inning, and MAN AG which recently bought out its Indian partner, Force Motors.

Daimler Benz has established a new local brand (*Bharat Benz*) and has invested in a new plant with a starting annual capacity of 36,000 vehicles. It plans to introduce three models by Sep'12 and will eventually introduce 17 vehicles in the 9te-49te range over a 20-month period. Asia Motor Works (AMW) has recently launched a new 16te tipper and is said to be planning capacity expansion. Mahindra Navistar produces vehicles from the newly completed Mahindra facility at Chakan (where other utility vehicles in the Mahindra stable are produced too, thus enabling economies of scale), and Volvo-Eicher continues to invest in capacity-addition programmes. While most of the new entrants – with the exception of VECV which has the advantage of Eicher's extensive experience in the domestic market – may take time to gain meaningful market share in India, the heightened competition may lead to sustained increase in discounting by the incumbents.

Table 9: Competition in HCV segment is likely to heat up…

OEM	When	Recent moves/announcements
Daimler Benz	H2CY12	Set up greenfield plant near Chennai with initial planned capacity of 36,000. Announced India-specific vehicle branding, *Bharat Benz*. Plans to launch three models by Sep'12, followed by 17 models over the next 20 months, covering the entire spectrum from 6te-49te CVs
Asia Motor Works	Launched	Launched 16te tipper. Said to be looking to raise US$100mn-150mn
Mahindra Navistar	Launched	Launched new >25te tippers and trucks; announced doubling of dealership to 100 in the next 12-18 months
MAN AG	Launched	Recently acquired Force Motors, its joint venture partner since 2006

Source: Company data, Media

Table 10: …as global majors have moved in

Manufacturer	HCVs sold worldwide (2010)	Global rank	In India since:
Isuzu	453,379	1	2006
Daimler Benz	306,903	2	2012e
Toyota	204,282	3	N/A
Tata Motors	171,454	4	1945
Volvo	170,861	5	2009
MAN AG	112,048	6	2006

Source: OICA, Media, I-Sec research

ALL has been losing share all across: its market share in the M&HCV segment declined to 19% in 9MFY12 from 23% in FY11 and 26% in FY07. The decline has mostly come from the >16te category, where the company lost market share to new players as well as incumbents like Tata Motors and Eicher Motors.

Chart 15: ALL has been losing market share in the M&HCV segment…

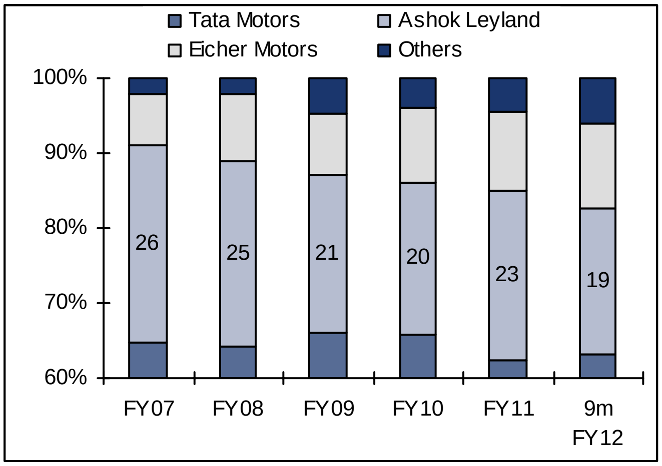
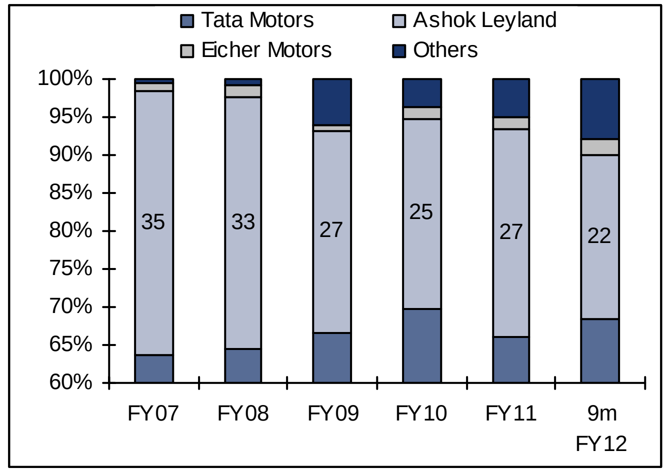


Chart 16:…mostly due to decline in share in the >16te HCV segment



Source: SIAM, I-Sec research

Chart 17: Market share has remained static in the <16te M&HCV segment…

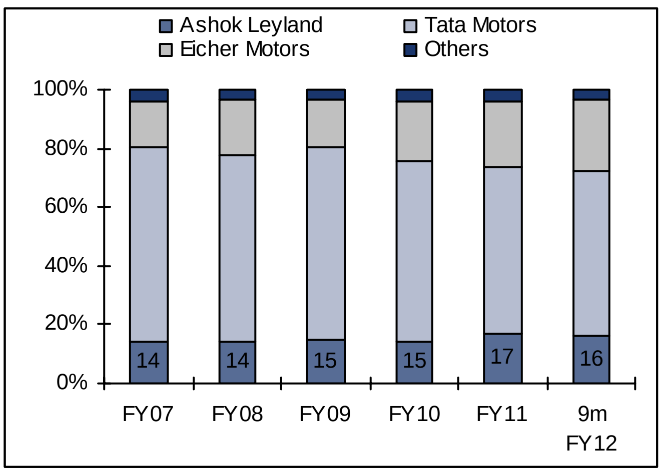
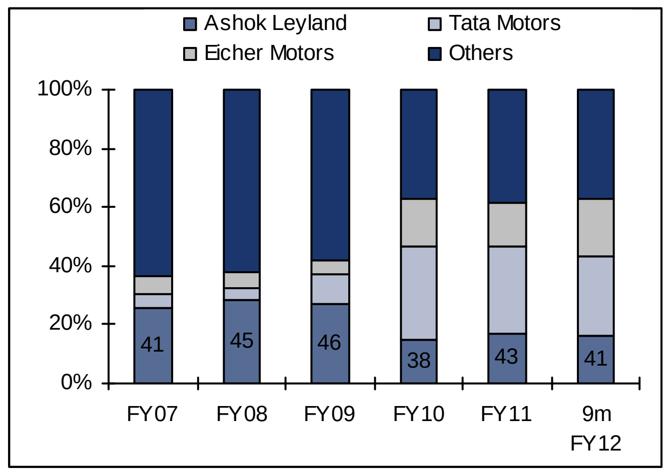
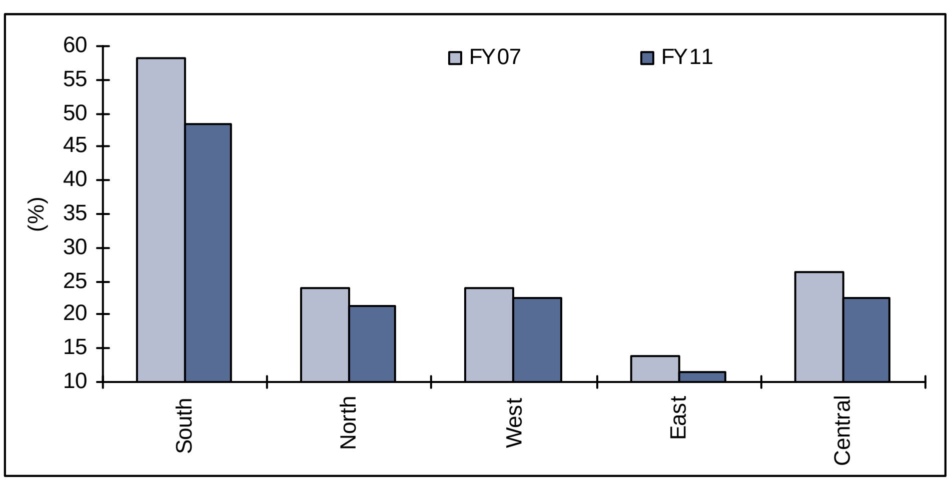


Chart 18: …and in the bus segment too



Source: SIAM, I-Sec research

Chart 19: ALL's market share loss has been across geographies



Source: Company data, I-Sec research

…but some trends are changing in favour of ALL

As the hub and spoke model of transportation develops in India, we expect CV demand to increasingly shift to tonnage peripheries, i.e. long-haul transport will be through HCVs with payload capacity of 25te+ and in-city transport would be through LCVs (primarily SCVs). This is a positive for ALL as it derives over 70% of its domestic volumes from M&HCVs. In the medium term however, given that infrastructure growth in India has stalled and competition from incumbents intensified, we expect growth to remain tepid. We do not expect the pace of infrastructure growth to recover meaningfully until H2FY13, which means that recovery in the CV industry itself will not happen until late FY13/early FY14.

Chart 20: Long-term trend indicates shift into heavier tonnage across segments…

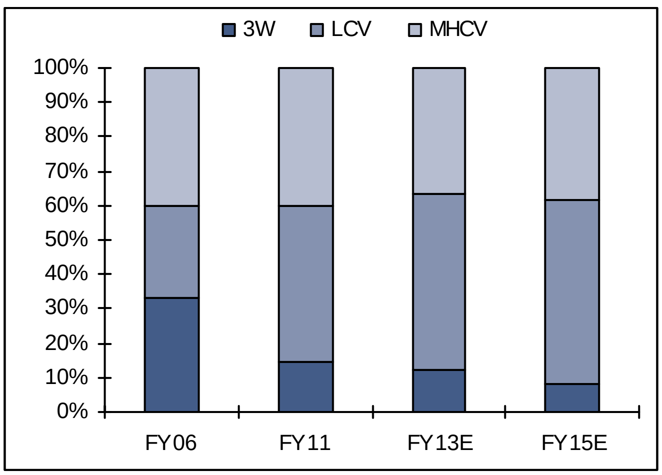
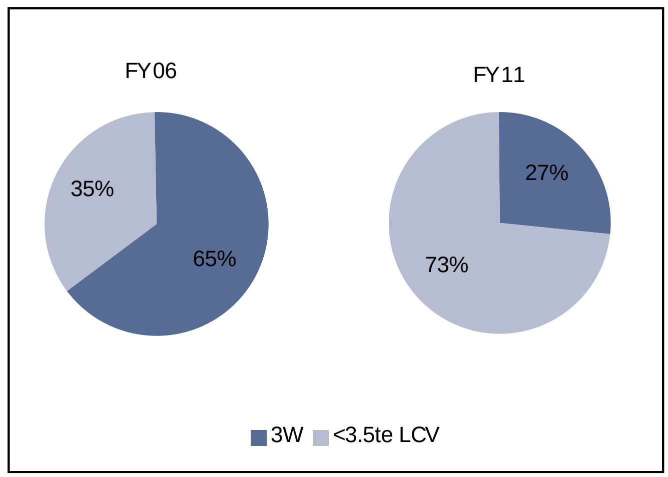


Chart 21: …as <3.5te CVs are substituting 3W goods carriers…



Source: SIAM, I-Sec research

Chart 22: Average tonnage of medium CVs is increasing...

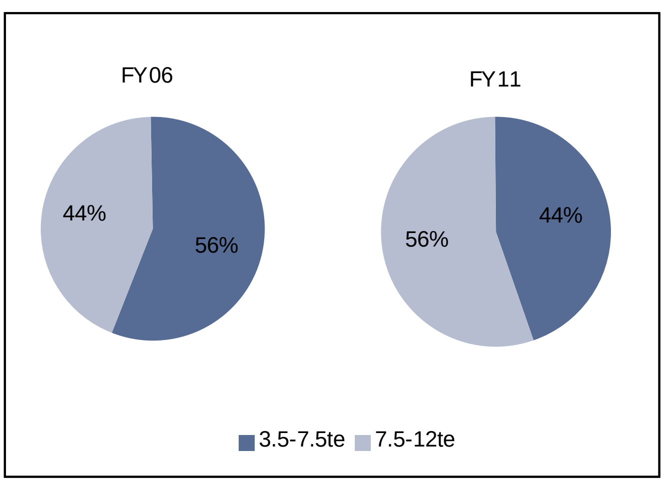
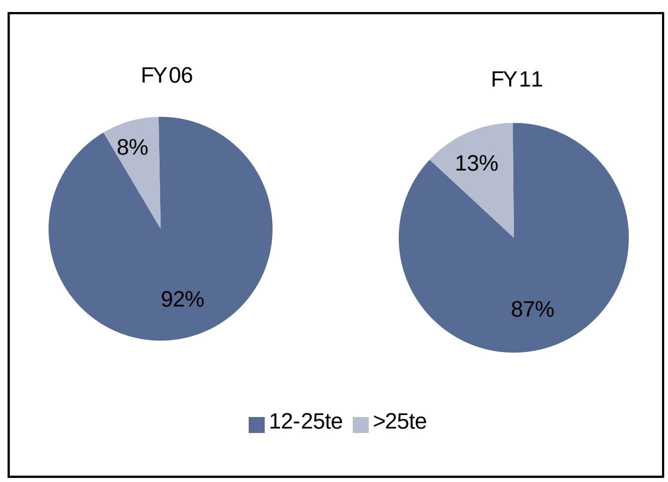


Chart 23: …and >25te vehicles account for more of HCV sales



Source: SIAM, I-Sec research

Joint ventures (JVs) and new initiatives

Ashok Leyland-Nissan: ALL has invested ~Rs5bn in its JV with Japan-based Nissan. The JV's first product, the *Dost* LCV was commercially launched in Jul'11. The JV intends to launch a portfolio of SCVs and LCVs in the Indian market. As detailed earlier, *Dost* vehicles are currently contract-manufactured at ALL's facilities in Hosur (Karnataka) but the JV has plans to set up its own manufacturing plant.

Leyland-Deere: Until Nov'11, ALL had invested ~Rs500mn in this 50:50 JV with UK-based John Deere. The JV launched its first commercial product, a backhoe loader, in Nov'11. The targeted capex in this JV is Rs4bn of which ~Rs1.5bn had been incurred as at end-CY11.

Hinduja Leyland Finance (HLF): ALL has made an equity investment of Rs1.3bn in HLF, which amounts to 40% the latter's total equity. This business has spread to ~400 locations (from 130 in Sep'11) and it financed 7.7% of ALL's unit sales in H1FY12.

Other investments: ALL has invested a total of ~Rs500mn in JVs with Finland's Alteams OY and Germany's Continental AG in the parts and engines segment.

ALL's bus manufacturer acquisitions: ALL acquired a 25% stake in UK-based bus manufacturer Optare Plc in 2010 and upped the stake to 75% in Dec'11. ALL also acquired Prague-based AVIA in 2006 to form Avia Ashok Leyland Motors.

U-Trucks: Adoption is the key…

"Currently we have a range of trucks which are typically built on to a standard chassis and then developed for a specific solution. Even though we have a wide range of products, it is still not comprehensive…. We want to offer customers a product which is completely customised to the application for which the truck will be used."

- ALL at the launch of *U-Trucks*

U-Trucks represent an overhaul of ALL's product platform. Launched in FY11, sales have been low thus far (~2,000 units sold in H1FY12) as fleet operators and other CV owners have been cautious about the operating performance of the hitherto untested models. Also, new parts have been used in the trucks, which require manufacturing side changes from vendors – leading to some production constraints in the first half of FY12. Although the *U-Truck* platform has had teething problems, ALL remains confident of demonstrating superior operating performance of the models coming from the new platform, which it expects will drive volume growth and command superior margins. We remain cautious on this and currently do not factor-in any margin expansion attributable to *U-Trucks*.

Company snapshot

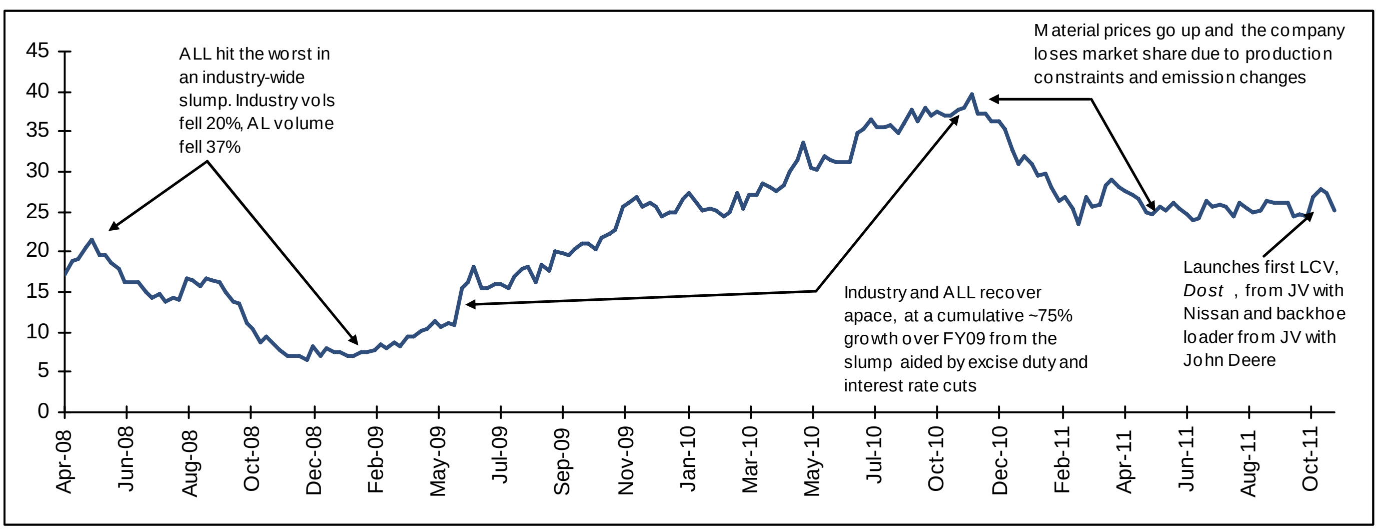
Ashok Leyland (ALL) is part of the Hinduja Group, a global conglomerate, and is headquartered in Chennai. Founded in 1948, the company has a traditional stronghold in the South Indian market for CVs and in buses, and is a national market leader. Overall, the company has the second-highest market share in CVs after Tata Motors in India. In recent years, ALL entered into joint ventures with global majors such as Japan's Nissan and the UK's John Deere, to foray into the LCV and construction equipment businesses in India. It has set up a state-of-the-art plant in Pantnagar (Uttarakhand) to cater to the North Indian markets, which started production in early 2010.

Table 11: Key board and management personnel

	Designation	Profile
Dheeraj Hinduja	Chairman	B.Sc. in economics and history from University of London and MBA from the Imperial College, London. Third-generation member of the Hinduja family, he leads the HR function for the group and the Indian business of which Ashok Leyland is the flagship.
R. Seshasayee	Executive Vice-Chairman	Was MD for 13 years before being appointed Vice-Chairman. He is also the chairman of the IndusInd Bank.
Vinod Daasari	Managing Director	MBA from Kellogg and Master's degree in engineering management from Northwestern University, US. Has worked with GE and Timken Company in the US and joined ALL as COO in 2005
A.K. Jain	Executive Director	B.Tech. (Mech) from IIT Kanpur. Joined ALL in 2006 and has over three decades of experience in project management.
R.R.G. Menon	Executive Director	Mechanical engineer from NIT Surathkal, Karnataka. Joined ALL in 1978 in product development which he now heads.
Jayendra Parikh	Executive Director	Has over 25 years of experience in the automotive industry. Currently heads ALL's advanced engineering group.
Anup Bhat	Executive Director	Is a metallurgist. Joined ALL in 2000 and has 22 years of experience in manufacturing. Heads manufacturing for the company
K. Sridharan	CFO	Has over three decades of experience at ALL.

Source: Company website

Chart 24: Stock history



Source: Bloomberg, I-sec research

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Financial summary (consolidated)

Table 12: Profit and Loss statement

(Rs mn, year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
Net sales	**72,090**	**110,947**	**123,217**	**134,186**	**151,849**
Commercial vehicles	60,806	98,187	109,268	118,849	134,451
Engines & gensets	3,319	3,202	2,698	2,398	2,518
Spare parts & others	7,966	9,557	11,251	12,939	14,880
Add: Other operating income - services	357	230	230	230	230
Total operating income	**72,447**	**111,177**	**123,447**	**134,417**	**152,080**
Less:					
Raw material consumed	52,193	81,235	90,452	98,317	111,278
Power and fuel	445	652	724	788	892
Personnel expenses	6,716	9,746	10,555	11,718	12,508
Selling and administration expenses	4,101	5,143	6,161	6,469	7,116
Other expenses	967	1,750	2,750	2,887	3,032
R&D	397	476	616	678	712
Total operating expenses	**64,819**	**99,002**	**111,258**	**120,857**	**135,538**
EBITDA	**7,628**	**12,176**	**12,190**	**13,559**	**16,542**
Margin (%)	*10.5*	*11.0*	*9.9*	*10.1*	*10.9*
Depreciation & Amortisation	2,041	2,674	3,418	3,930	4,142
Other income	364	387	255	253	364
EBIT	**5,951**	**9,888**	**9,027**	**9,882**	**12,763**
Less: Gross interest	1,019	1,889	2,315	2,455	2,175
Recurring pre-tax income	**4,933**	**7,999**	**6,712**	**7,428**	**10,589**
Add: Extraordinary income	548	19	-	-	-
Less: Extraordinary expenses	33	-	-	-	-
Less: Taxation	1,211	1,705	1,477	1,634	2,435
Net income (reported)	**4,237**	**6,313**	**5,235**	**5,794**	**8,153**

Source: Company data, I-Sec research

Table 13: Balance sheet

(Rs mn, year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
ASSETS					
Current assets, loans & advances					
Cash & bank balance	5,189	1,795	1,505	1,748	3,964
Inventory	16,382	22,089	24,781	26,936	30,487
Sundry debtors	10,221	11,852	13,528	14,731	16,666
Loans and advances	8,729	6,229	6,229	6,229	6,229
Operational		6,229	6,229	6,229	6,229
Other current assets	876	1,707	1,707	1,707	1,707
Total current assets	**41,397**	**43,672**	**47,751**	**51,350**	**59,053**
Current liabilities & provisions					
Current liabilities	**25,921**	**30,379**	**33,530**	**36,423**	**40,847**
Sundry creditors	23,317	27,736	30,482	33,112	37,134
Other current liabilities	2,643	2,643	3,048	3,311	3,713
Provisions	3,687	4,903	6,096	6,622	7,427
Total current liabilities and provisions	**29,608**	**35,283**	**39,626**	**43,045**	**48,274**
Net current assets	**11,789**	**8,390**	**8,125**	**8,305**	**10,780**
Investments					
Strategic & group investments	2,380	11,115	16,691	17,696	17,696
Other marketable investments	881	1,185	1,185	1,185	1,185
Total investments	**3,262**	**12,300**	**17,876**	**18,881**	**18,881**
Fixed assets					
Gross block	60,186	66,919	75,499	81,699	83,999
Less accumulated depreciation	17,691	20,581	23,999	27,929	32,071
Net block	42,496	46,338	51,500	53,770	51,927
Add: Capital work in progress	5,615	3,580	3,000	300	1,000
Less: Revaluation reserve	13,332	13,063	13,063	13,063	13,063
Total fixed assets	**34,779**	**36,855**	**41,437**	**41,007**	**39,864**
Total assets	**49,829**	**57,545**	**67,438**	**68,193**	**69,525**
LIABILITIES AND SHAREHOLDERS' EQUITY					
Borrowings					
Short term debt	1024	1024	1024	1024	1024
Long term debt	21,015	24,658	31,158	28,158	24,158
Total borrowings	**22,039**	**25,683**	**32,183**	**29,183**	**25,183**
Deferred tax liability	4,611	**5,338**	**5,852**	**6,421**	**7,269**
Share capital					
Paid up equity share capital	1,330	1,330	2,661	2,661	2,661
No. of shares outstanding (mn)	1,330	1,330	2,661	2,661	2,661
Face value per share (Rs)	*1*	*1*	*1*	*1*	*1*
Reserves & surplus	**22,025**	**25,237**	**26,786**	**29,972**	**34,457**
Share premium	8,903	8,903	7,573	7,573	7,573
General & other reserve	13,122	16,333	19,213	22,399	26,883
Less: Misc. exp. not written off	52	43	43	43	43
Less: Revaluation reserve					
Net worth	**23,304**	**26,524**	**29,403**	**32,590**	**37,074**
Total liabilities & shareholders' equity	**49,829**	**57,544**	**67,438**	**68,193**	**69,525**

Source: Company data, I-Sec research

Table 14: Cashflow statement

(Rs mn, year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
Cash flow from operating activities					
Reported net income	4,237	6,313	5,235	5,794	8,153
Add:					
Depreciation & Amortisation	2,194	2,899	3,418	3,930	4,142
Provisions	1,006	1,216	1,193	526	804
Deferred taxes	1,976	727	514	569	848
Less:					
Other income	364	387	255	253	364
Net extra-ordinary income	515	19	-	-	-
Op. cash flow before working capital change (a)	**8,535**	**10,749**	**10,105**	**10,565**	**13,584**
Changes in working capital					
(Increase) / Decrease in inventories	(3,082)	(5,707)	(2,692)	(2,155)	(3,551)
(Increase) / Decrease in sundry debtors	(641)	(1,632)	(1,676)	(1,202)	(1,936)
(Increase) / Decrease in operational loans & Adv.	(2,078)	2,500	-	-	-
(Increase) / Decrease in other current assets	(369)	831	-	-	-
Increase / (Decrease) in sundry creditors	5,604	4,419	2,746	2,630	4,022
Increase / (Decrease) in other current liabilities	1,668	-	405	263	402
Working capital inflow / (Outflow) (b)	**1,101**	**412**	**(1,218)**	**(464)**	**(1,063)**
Net cash flow from operating activities (a) + (b)	**9,636**	**11,162**	**8,887**	**10,101**	**12,522**
as a % of operating cash flow	*113*	*104*	*88*	*96*	*92*
Cash flow from capital commitments					
Purchase of fixed assets	(6,429)	(4,698)	(8,000)	(3,500)	(3,000)
Purchase of investments	(134)	(8,735)	(5,576)	(1,005)	0
Consideration paid for acquisition of undertaking					
Cash Inflow/(outflow) from capital commitments (c)	**(6,562)**	**(13,432)**	**(13,576)**	**(4,505)**	**(3,000)**
Free cash flow after capital commitments					
(a) + (b) + (c)	**3,074**	**(2,271)**	**(4,689)**	**5,596**	**9,522**
Cash Flow from Investing Activities					
Purchase of Marketable Investments	**(492)**	**(304)**	**-**	**-**	**-**
Other income	364	387	255	253	364
Net cash flow from investing activities (d)	**(128)**	**83**	**255**	**253**	**364**
Cash flow from financing activities					
Proceeds from fresh borrowings	2,457	3,644	6,500	-	-
Repayment of borrowings	-	-	-	(3,000)	(4,000)
Dividend paid including tax	(2,327)	(3,092)	(2,356)	(2,607)	(3,669)
Others	193	115	-	-	-
Net cash flow from financing activities (e)	**323**	**666**	**4,144**	**(5,607)**	**(7,669)**
Net extra-ordinary income (f)	**515**	**19**	**-**	**-**	**-**
Opening cash and bank balance	**881**	**5,189**	**1,795**	**1,505**	**1,748**
Closing cash and bank balance	**5,189**	**1,795**	**1,505**	**1,748**	**3,964**
Increase/(Decrease) in cash and bank balance	**4,308**	**(3,394)**	**(290)**	**242**	**2,216**

Source: Company data, I-Sec research

Table 15: Key ratios

(Year ending March 31)

	FY10	FY11	FY12E	FY13E	FY14E
Per share data (Rs)					
Diluted recurring earning per share (DEPS)	1.4	2.4	2.0	2.2	3.1
Diluted earnings per share	3.2	2.4	2.0	2.2	3.1
Recurring cash earnings per share (CEPS)	2.4	3.4	3.3	3.7	4.6
Free cash flow per share (FCPS-post capex)	2.4	2.4	0.3	2.5	3.6
Reported book value (BV)	17.5	10.0	11.1	12.3	13.9
Dividend per share	1.5	1.0	0.8	0.8	1.2
cash per share (net of debt)	(12.0)	(17.1)	(11.1)	(9.9)	(7.5)
Valuation ratios (x)					
Diluted price earning ratio	9.5	12.8	15.4	13.9	9.9
Price to recurring cash earnings per share	12.8	9.0	9.3	8.3	6.6
Price to book value	1.7	3.0	2.7	2.5	2.2
EV / EBITDA	13.3	8.9	9.5	8.4	6.5
EV / Total operating income	1.4	1.0	0.9	0.8	0.7
EV / Operating free cash flow (Pre-capex)	10.5	9.7	13.0	11.2	8.6
EV / Net operating free cash flow (Post-capex)	31.6	16.8	130.7	17.2	11.3
Dividend yield (%)	4.9	3.3	2.5	2.8	3.9
Growth ratios (% YoY)					
Diluted recurring EPS growth	114.2	64.2	-16.9	10.7	40.7
Diluted recurring CEPS growth	70.4	43.2	-3.7	12.4	26.5
Total operating income growth	21.1	53.5	11.0	8.9	13.1
EBITDA growth	62.5	59.6	0.1	11.2	22.0
Recurring net income growth	114.2	64.2	-16.9	10.7	40.7
Operating ratios (%)					
EBITDA margins	10.5	11.0	9.9	10.1	10.9
EBIT margins	8.2	8.9	7.3	7.4	8.4
Recurring pre-tax income margins	6.8	7.2	5.4	5.5	7.0
Recurring net income margins	5.3	5.7	4.2	4.3	5.4
Raw material consumed / Sales	72.0	73.1	73.3	73.1	73.2
SGA expenses / Sales	5.7	4.6	5.0	4.8	4.7
Other income / Pre-tax income	7.4	4.8	3.8	3.4	3.4
Other operating income / EBITDA	4.7	1.9	1.9	1.7	1.4
Effective tax rate	24.6	21.3	22.0	22.0	23.0
Return / Profitability ratios (%)					
Return on capital employed (RoCE)-Overall	9.9	14.5	11.3	11.4	14.3
Return on invested capital (RoIC)	17.8	24.8	20.4	20.9	25.5
Return on net worth (RoNW)	17.3	25.3	18.7	18.7	23.4
Dividend payout ratio	54.9	49.0	45.0	45.0	45.0
Solvency ratios / Liquidity ratios (%)					
Debt equity ratio (D/E)	114.4	117.0	129.4	109.2	87.5
Long term debt / Total debt	96.2	96.7	97.3	97.1	96.8
Net working capital / Total assets	11.5	9.4	8.1	7.9	8.1
Interest coverage ratio-based on EBIT	17.1	19.1	25.6	24.8	17.0
Current ratio	153.6	139.1	138.2	137.1	141.0
Cash and cash equivalents / Total assets	12.2	5.2	4.0	4.3	7.4
Turnover ratios					
Inventory turnover ratio (x)	3.5	4.3	3.9	3.8	3.9
Assets turnover ratio (x)	1.6	2.1	2.0	2.0	2.2
Working capital cycle (days)	55.6	33.1	24.4	22.3	22.9
Average collection period (days)	49.9	36.2	37.5	38.4	37.7
Average payment period (days)	143.5	114.7	117.5	118.0	115.2

Source: Company data, I-Sec research

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Tables

Charts

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