FRR SHARES

Company Research

Ashok Leyland - Hold

Investment overview

- Ashok Leyland is the 2nd largest commercial vehicle manufacturer in India.
- The management of the company has guided a volume of over 1 lakh units in FY2012 and has projected its market share to move up to 25.6% from 20.2%.
- The company is expecting strong export performance from Latin American and African countries to continue.
- Ashok Leyland is the largest supplier of logistics vehicles to the Indian Army.

Business Overview

Ashok Leyland, the flagship company of the Hinduja Group is one of the largest commercial vehicle manufacturers in India. The company is headquartered in Chennai and has manufacturing footprint pan-India with two international facilities in Prague (Czech Republic) and Ras Al Khaimah (UAE). With the Ras Al Khaimah Investment Authority, the company has set up a state-of-the-art manufacturing facility at Ras Al Khaimah, UAE, with an initial annual capacity to manufacture 2,000 vehicles of international quality. With seven manufacturing locations at Chennai, Hosur (three plants), Alwar, Bhandara and Pantnagar (Uttarakhand), the Company has a production capacity of 150,000 vehicles.

Hinduja Group is a multi-billion dollar, transnational conglomerate. The Group's activities span across three core areas: Investment Banking, International Trading and Global Investments, and is having operations across 40 countries.

The company has inked 50:50 Joint Ventures (JV) with Nissan Motor Company (Japan) for Light Commercial Vehicles and John Deere (USA) for construction equipment. Its JV with Continental AG (Germany) is for developing automotive Infotronics while the one with the Alteams Group is for producing high press die casting extruded aluminum components for both the automotive and telecommunication sectors.

Financial Health

Ashok Leyland has posted a decline in net profit of 7.77% to Rs 154.08 crore for the quarter ended September 30, 2011 as against Rs 167.06 crore for the same quarter last year. The company has registered a 14% increase in turnover at Rs 3,094.6 crore during the second quarter compared to Rs 2714.0 crores for the corresponding quarter of 2010-11. Sale of vehicles for the quarter stood at 23,659 numbers, down by 3.78% as against 24,589 nos. with domestic volumes declining by 8.14% to 20,429 nos. from 22,239 nos. However, exports increased by 37.4% to 3,230 nos. against 2,350 nos.

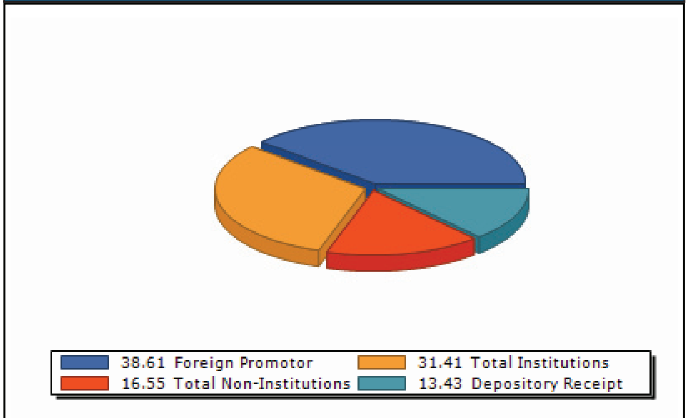
The Company's EBITDA for the quarter was up 8.6%, at Rs. 331.2 crore from Rs 304.8 crore. Financial Expenses however surged by 58.73% to Rs 62.7 crore from Rs 39.5 crore and so also was depreciation moving higher by 34.01% to Rs 85.9 crore from Rs 64.1 crore.

Industry Scenario

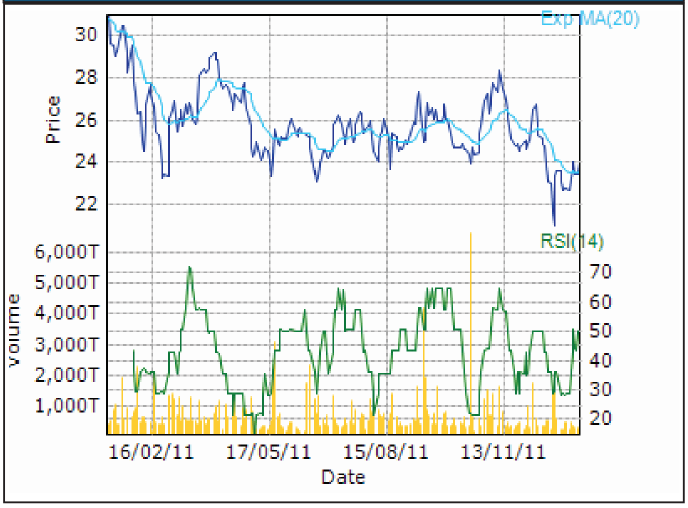
The automobile sector is one of the high performing sectors of

Stock Data	20/01/2012
Current Mkt Price (Rs)	26.45
52 Week High	31.43
52 Week Low	20.05
Mkt Cap (Rs. in Cr.)	7037.00
Return in last one Month (%)	22.71

Share Holding



Performance in last one year



Y-o-Y Performance

(Rs. in Million)

Particulars	Mar 2011	Mar 2010	Change(%)
Net Sales	11365.99	7407.23	53.44
Other Income	40.60	95.49	-57.49
Total Expenditure	10148.43	6648.71	52.64
Operating Profit	1258.15	854.01	47.32
Interest	188.92	101.85	85.49
Profits After Tax	631.30	423.67	49.01
Reserve & Surplus	0.04	0.04	8.32
Reported EPS(Rs)	4.75	3.18	49.01
Core EBITDA Margin (%)	9.87	9.44	4.50

the Indian economy. This has contributed largely in making India a prime destination for many international players in the automobile industry who wish to set up their businesses in India. The automobile sector in India was opened up to foreign investments in the year 1991. 100% Foreign Direct Investment (FDI) is allowed in the automobile industry in India. Heavy vehicles industry in India has reflected a steady growth over the last decade by constantly trying to upgrade their technology and production processes. Heavy vehicles in India are mostly made by companies like Tata motors and Ashok Leyland. Heavy Vehicles or (HCVs) however form an indispensable part of the Indian automobile industry.

The fortunes of the CV industry are linked to the economic growth, as there is a direct correlation between the CV industry and country's GDP and IIP growth. The CV sales cycle broadly follows the industrial trend. Thus, in the phase of declining industrial growth, incremental freight also falls. This leads to fall in requirement of incremental trucks, which ultimately results in the CV segment reporting de-growth.

The overall Commercial Vehicles segment registered growth of 19.95 percent during April-November 2011 as compared to the same period last year. While Medium & Heavy Commercial Vehicles (M&HCVs) registered growth of 9.39 percent, Light Commercial Vehicles grew at 29.26 percent. However, in the month of November 2011 over November 2010, the growth in sales of the overall CV segment was 34.99 percent. Two Wheelers, Commercial Vehicles and Three Wheelers segments recorded growth of 31.09 percent, 25.95 percent and 44.21 percent respectively during April-November 2011.

The demand for heavy vehicles in India is increasing by the day due to the expansion and the growth of the Indian economy as a whole. This demand for heavy vehicles has in turn resulted in the manufacture of a series of heavy vehicles by the heavy vehicle manufacturing companies. SIAM has forecast 13-15% growth in Commercial vehicle sale in 2011-12.

Latest developments:

The UK-based bus manufacturer Optare Plc's shareholders have given approval for Hinduja Group-owned Ashok Leyland and associates to increase their stake to 75.1 per cent in it. Ashok Leyland will have 25.34 per cent, and associated companies, Ashley Holdings 23.22 per cent and Ashley Investments 26.54 per cent.

Investment Rationale

- Ashok Leyland was unable to perform well in the second quarter in volume terms, despite the fact that Q2 historically has been one of the best quarters in terms of volumes, operating margins and profitability. Its truck volumes have underperformed not only the market leader Tata Motors but even many of the smaller peers in the last two quarters, however the bus segment performed well in the passing two quarters when the industry average declined, indicating a likely robust performance in the future. Apart from this the gross margins of the company declined by 140bps Q-o-Q to 26.5% despite an improvement in product mix and ramp up at Pantnagar plant. The company has bolstered its

Q-o-Q Performance

(Rs. in Million)

Particulars	Sep 2011	Sep 2010	Change(%)
Net Sales	3094.57	2713.96	14.02
Expenditure	2763.42	2407.70	14.77
Other Income	10.33	4.81	114.52
EBITDA	341.48	311.07	9.78
Interest	62.70	39.48	58.79
Net Profit	154.08	167.06	-7.77
EBITDA Margin (%)	0.11	0.11	-3.73
NPM (%)	0.05	0.06	-19.11
EPS	0.58	1.26	-53.97

Profit & Loss

(Rs. in Million)

Particulars	Mar 2011	Mar 2010	Change(%)
Net Sales	11365.99	7407.23	53.44
Total Income	11406.59	7502.72	52.03
Total Expenditure	10148.43	6648.71	52.64
Operating Profit	1258.15	854.01	47.32
Profits After Tax	631.30	423.67	49.01

Balance Sheet

(Rs. in Million)

Particulars	Mar 2011	Mar 2010	Change(%)
Share Capital	133.03	133.03	0.00
Reserve & Surplus	3829.93	3535.72	8.32
Total Liabilities	6621.15	5936.75	11.53
Investments	1230.00	326.15	277.12
Current Liabilities	3037.95	2592.07	17.20
Net Current Assets	838.97	1178.93	-28.84
Total Assests	6621.15	5936.75	11.53

Key Ratios

Particulars	Mar 2011	Mar 2010
Reported EPS (Rs)	4.75	3.18
Core EBITDA Margin (%)	9.87	9.44
EBIT Margin (%)	8.03	8.05
ROA (%)	10.05	7.45
ROE (%)	25.34	19.13
ROCE (%)	20.00	14.93
Price/Book (x)	2.85	3.19
Net Sales Growth (%)	53.44	21.46
EBIT Growth (%)	53.21	75.35
PAT Growth (%)	49.01	122.99
Total Debt/Mcap (%)	0.70	0.61

Peer group comparison (Rs. crore)

*latest based on last traded price

Company	Year End	Net Sales	PBDIT	PAT	PATM%	EPS	P/E*
Ashok Leyland	201103	11365.99	1217.56	631.30	5.55	4.75	12.09
Tata Motors	201103	48040.46	4518.02	1811.82	3.77	28.55	39.63
Eicher Motors	201012	438.47	40.47	75.44	17.21	28.00	44.72
Force Motors	201103	1481.44	56.67	58.62	3.96	44.49	11.80

marketing initiatives and has bagged an order to supply 700 front-engine, semi-low floor buses from A B Grain, which has been awarded the contract to run Semi Low Floor buses in clusters 3,4 and 5 by the Delhi government this year after it decided to award the 17 identified clusters of the city to private operators under the DMITS.

- Ashok Leyland and John Deere have recently announced their entry into the rapidly growing Indian construction equipment business through their 50:50 joint venture, with the launch of their first product, the 435 Backhoe Loader. The products will be marketed under the brand LEYLAND DEERE. With the new brand two strong partners combined, each bringing to the association their unique individual strengths and competencies. John Deere brings in their advanced technical knowhow and vast experience in the global construction equipment space while Ashok Leyland lends in-depth knowledge of the Indian market, proven expertise in manufacturing, sourcing and distribution, to this strategic partnership. The 435 BHL is being manufactured at LEYLAND DEERE's brand new facility at Gummidipoondi, 50 kms from Chennai.

- Recently the board of the company approved the proposal for making additional investment upto GBP 4,004,495 in Optare plc. U.K. Following completion of the placing, Ashok Leyland intended to grow Optare's business, in part by using it's expertise in launching cost-effective bus models suitable for application in various countries and integrating the technologies it uses with the design and production capabilities of Optare. As a first step, Leyland will carry out a strategic review of Optare's business and operations, focusing in particular on how Leyland might further assist Optare to improve productivity within its business, through the cost-effective sourcing of materials on a global basis and through the launch of new models.

- Ashok Leyland is the largest supplier of logistics vehicles to the Indian Army and in the last quarter average realisation/vehicle was higher on account of higher sales to the defence sector only. Ashok Leyland Defence Systems (ALDS) and Krauss-Maffei Wegmann GmbH & Co. KG (KMW), based in Munich, Germany, signed a Memorandum of Understanding during the International Defence Exhibition (IDEX) at Abu Dhabi. Both firms will co-operate in the development of advanced defence systems for the Indian defence establishment as well as other defence forces worldwide and will initially develop armoured wheeled vehicles, recovery vehicles, artillery and combat systems, bridge laying systems and other similar products. In its other global endeavor, the company has entered the Russian market in partnership with Volgabus - the renowned bus manufacturer from Russia, known for their large buses (12m, 15m multi-axle and 18m vestibule buses). Volgabus has designed a proto lightweight minibus using the chassis of Ashok Leyland's Eagle 816 E-IV. This minibus uses fibreglass and composite material. Volgabus, has ordered 300 chassis marking the company's entry in to the Russian market.

- At the current market price of Rs 26.45, Ashok Leyland is trading at PE of 12.09x and 13.10x FY12E respectively, we would recommend 'HOLD' in the scrip and buying at dips with a price target of Rs 32 for a long term outlook. The Company during the period ended September 30, 2011, modified the method of amortization of value of leasehold land from lower of 40 years and the period of lease to the period of lease. The impact of the said modification was net reduction in 'Other Expenditure' by Rs 9.46 crore for the quarter and six months period ended September 30, 2011. Though, the company has shown good improvement in its overall performance but with fuel costs comprising over 60% of operating costs, fuel efficiency remains a big worry. Inflationary pressures are constantly pushing fuel rates up and keeping fuel costs in check, the next two quarter too will be constrained with the impact of rising interest rate and exposure to the southern market where issues related to mining ban in Karnataka and Telangana issues in AP resulted in drop in performances, however the company is likely to get some relief from the lower tax rates due to ramp up in tax-free Uttarakhand plant. Also, the company's aggressive plan to increase its distribution in other geographies along with other marketing initiatives may help it to recover its market share. The company has been making active investments in expanding its network. In the last over 20 months alone it has added over 80 customer touch points and today has over 370 points of contact along major national highway corridors and across strategic locations. The company is planning to increase the number to over 400 by the end of this financial year