EQUITY REPORT

Ashok Leyland Ltd.

November 28th, 2014

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Ashok Leyland Ltd, incorporated in September 1948, is the second largest manufacturer of M&HCVs (Medium & Heavy Commercial Vehicles) in India, the fourth largest manufacturer of buses in the world and the sixteenth largest manufacturer of trucks globally. Ashok Leyland is the flagship company of the Hinduja group, with the group holding 51% stake in the company. Headquartered in Chennai (India), the company is one of the most fully-integrated manufacturing companies with its footprints across 50 countries across the globe.

Investment Rationale

Strong numbers in Q2FY15 backed by richer product mix - Ashok Leyland reported a strong set of numbers in Q2FY15 with 26.2% YoY growth in topline at ₹32,176.8 mn as against ₹25,496.2 mn for the corresponding period last year. On a big turnout, the company managed to report EBITDA margins of 7.3% in Q2FY15 as against 2.2% in Q2FY14 led by richer product mix and operating leverage. Going ahead, the ongoing recovery in commercial vehicle (CV) segment, moderation in diesel prices and potential rate cuts should lend an added boost to volume growth. Further, we expect margins to remain stable on account of richer product mix and higher sales volume.

Market share increased to 27.1% in H1FY15 driven by stronger growth in Southern markets - Ashok Leyland's market share has improved to 27.1% in H1FY15 as compared to 25.8% in FY14. The growth in the market share was driven by stronger growth in Southern markets where the company has higher market share coupled with market share gains in other regions as well. We believe that the stronger growth in higher tonnage segments (where Ashok Leyland has higher market share) will also help the company to further expand market share in the CV segment.

Expects a pick up in CV volumes - Ashok Leyland expects that the CV volumes are likely to pick up especially in the M&HCV segment owing to a mix of replacement/fresh demand. Ashok Leyland, being at the dominant position is likely to outpace industry growth owing to sharper improvement in business climate that may trigger growth in terms of both volume and value in the next couple of years.

Debt - no more a major concern - In a move to bring down the debt level, the company is actively looking to sell stakes in its overseas subsidiaries, Albonair GmbH (also Albonair India) and Avia Ashok Leyland Motors Ltd. The company has been able to reduce the debt to ₹36,979.7 mn in H1FY15, as against ₹38,839.1 mn in FY14 and remains sharply focused on reducing working capital and lowering debt. We expect the company's efforts to lower down it debt will improve company's profitability in the company quarters.

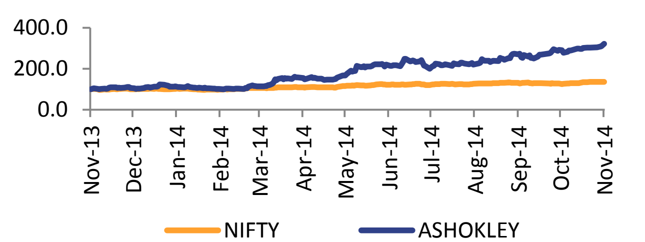
Market Data

Rating	**BUY**
CMP (₹)	52
Target (₹)	**62**
Potential Upside	~20%
Duration	Long Term
Face Value (₹)	1.0
52 week H/L (₹)	56.2/14.9
Adj. all time High (₹)	56.2
Decline from 52WH (%)	8.0
Rise from 52WL (%)	248.1
Beta	1.6
Mkt. Cap (₹bn)	137.6
Enterprise Value (₹bn)	176.3

Fiscal Year Ended

Y/E	FY13A	FY14A	FY15E	FY16E
Revenue (₹bn)	124.8	99.4	121.2	148.4
EBITDA (₹bn)	8.8	1.7	8.7	13.4
Net Profit (₹bn)	4.3	0.3	1.6	3.8
EPS (₹)	1.6	0.1	0.6	1.3
P/E (x)	31.7	468.2	91.4	38.3
P/BV (x)	3.1	3.1	2.8	2.7
EV/EBITDA (x)	19.7	105.8	19.8	12.8
ROCE (%)	7.2	(1.8)	6.5	11.2
ROE (%)	9.7	0.7	3.1	7.0

One year Price Chart



Shareholding Pattern	Sep'14	Jun'14	Diff.
Promoters	38.8	38.8	-
FII	21.4	21.3	0.1
DII	13.3	12.9	0.4
Others	26.5	27.0	(0.5)

Ashok Leyland Ltd – the 2nd largest M&HCV player in India

Ashok Leyland is the 2nd largest manufacturer of M&HCV with ~26% market share and the largest Bus manufacturer in India.

Ashok Leyland Ltd, the flagship company of Hinduja Group, is the 2nd largest manufacturer of the M&HCVs with ~26% market share and is also among the largest bus manufacturer in the world. Hinduja Group holds 51% stake in the company through its holding company, Hinduja Automotive (UK). The company has six manufacturing plants at four locations in India—Ennore (Tamil Nadu), Hosur (Tamil Nadu), Alwar (Rajasthan), Bhandara (Maharashtra) and Pantnagar (Uttaranchal). It focuses on the M&HCV segment and has a significant presence in the bus segment. To expand its product offerings, Ashok Leyland has entered into 50:50 JV with Nissan for LCVs and John Deere for construction equipment.

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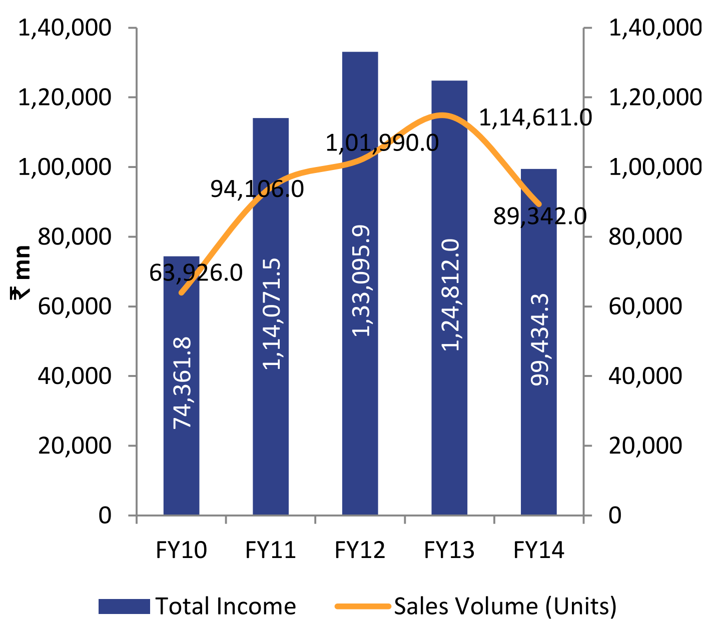
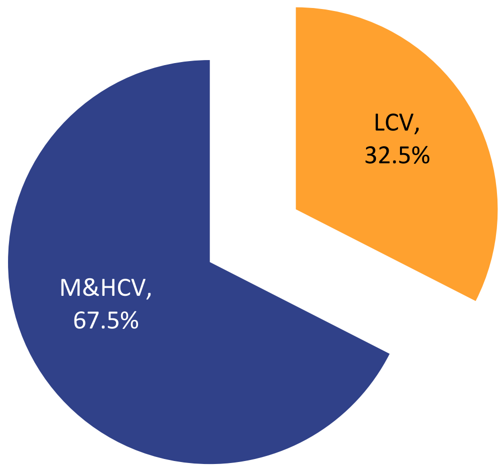
With a consolidated turnover in excess of ₹114 bn in FY14, Ashok Leyland is the 2nd largest commercial vehicles manufacturer in India, 4th largest manufacturer of buses in the world and the 16th largest manufacturer of trucks globally. With its headquartered in Chennai, India, the company's manufacturing footprint spreads across the globe with 8 plants; including one at Ras Al Khaimah (UAE) and has its global footprint that extends across 50 countries. Ashok Leyland is one of the most fully-integrated manufacturing companies this side of the globe. To avail the advantages of diversification and reap the benefits of entering profitable adjacencies, the company has forged a series of Joint Ventures (JV) with various global leaders. The company's Joint Venture partners include Nissan Motor Company (Japan) for Light Commercial Vehicles, John Deere (USA) for Construction Equipment, Continental AG (Germany) for Automotive Infotronics and the Alteams Group for the manufacture of high-press die-casting extruded aluminum components for the automotive and telecommunications sectors.

Total Income (in ₹mn) and sales volume (Units) trend



Segment wise revenue (FY14)



Commendable performance during Q2FY15 and H1FY15

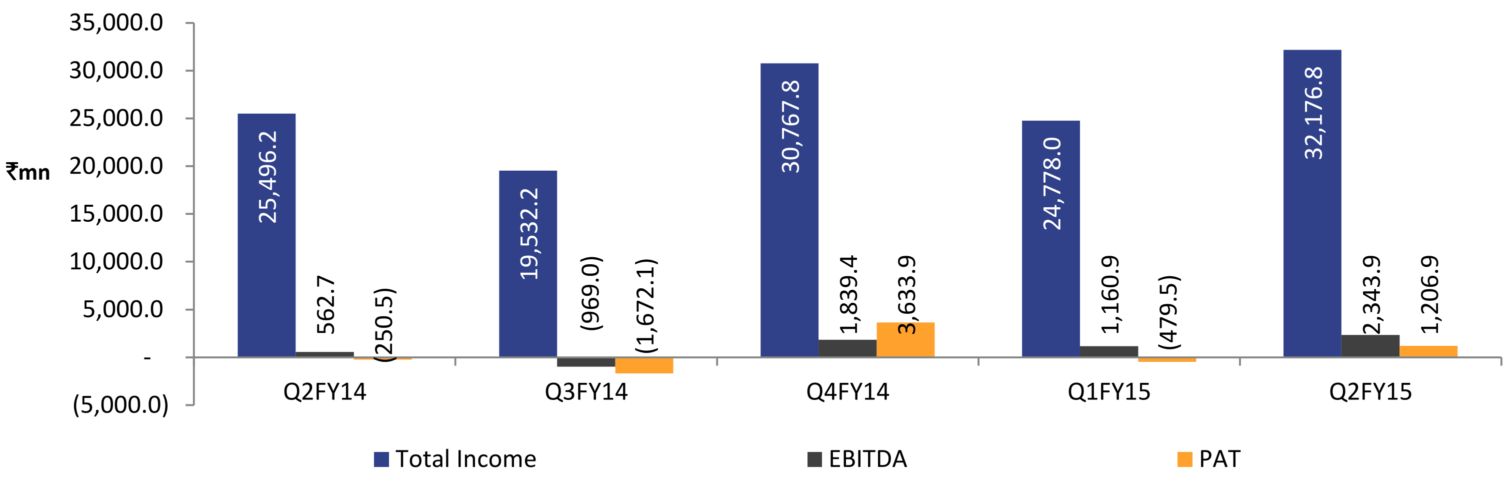
The company reported a net profit of ₹1,206.9 mn in Q2FY15 as against a net loss of ₹250.5 mn in Q2FY14.

The company's EBITDA margins which came in at 7.3% saw a huge jump as compared to 2.2% in the year ago quarter.

Reported a net profit of ₹1,206.9 mn in Q2FY15: Ashok Leyland reported a good set of numbers in Q2FY15 with the company reporting a net profit of ₹1,206.9 mn in Q2FY15 on standalone basis as against a net loss of ₹250.5 mn in a year ago period, on back of better sales and one-time gain of ₹1,089.7 mn due to profit on sale of immovable assets. Further, the total operating income increased by 26.2% YoY to ₹32,176.8 mn as against ₹25,496.2 mn for the corresponding period last year. This growth in the total operating income was largely contributed by 9.8% jump in total sales volumes to 25,379 units during Q2FY15 as against 23,117 units during Q2FY14.

EBITDA margin expanded by 510bps YoY: The company witnessed a huge jump in its EBITDA margins which came in at 7.3% (up by 510bps YoY) as compared to 2.2% in the year ago quarter on the back of higher operating leverage as well as better product mix. During the quarter, the company sold higher number of defence kits which fetch better margins, thus aid to margins. Further, the company has managed to bring down debt from peak levels of ₹62.0 bn last year to about ₹43.0 bn at the end of the September quarter.

Quarterly Performance trend



Revenues grew by 15.9% YoY and stood at ₹56,954.8 mn as against ₹49,134.4 mn for the corresponding period last year.

The company's total sales volumes grew by merely 1.1% YoY to 45,319 in H1FY15 as against 44,841 vehicles in H1FY14.

Performance remained robust in H1FY15: The recent half yearly performance also remains impressive with the company reporting a net profit of ₹727.3 mn during H1FY15 on standalone basis as against a loss of ₹1,668.0 mn for the corresponding period last year. Revenues also increased by 15.9% YoY and stood at ₹56,954.8 mn as against ₹49,134.4 mn for the corresponding period last year.

During the first half of FY15, the company's total sales volumes grew by merely 1.1% YoY to 45,319 in H1FY15 as against 44,841 vehicles in H1FY14. This grown in volumes was largely supported by 7.4% YoY volume growth in M&HCV segment.

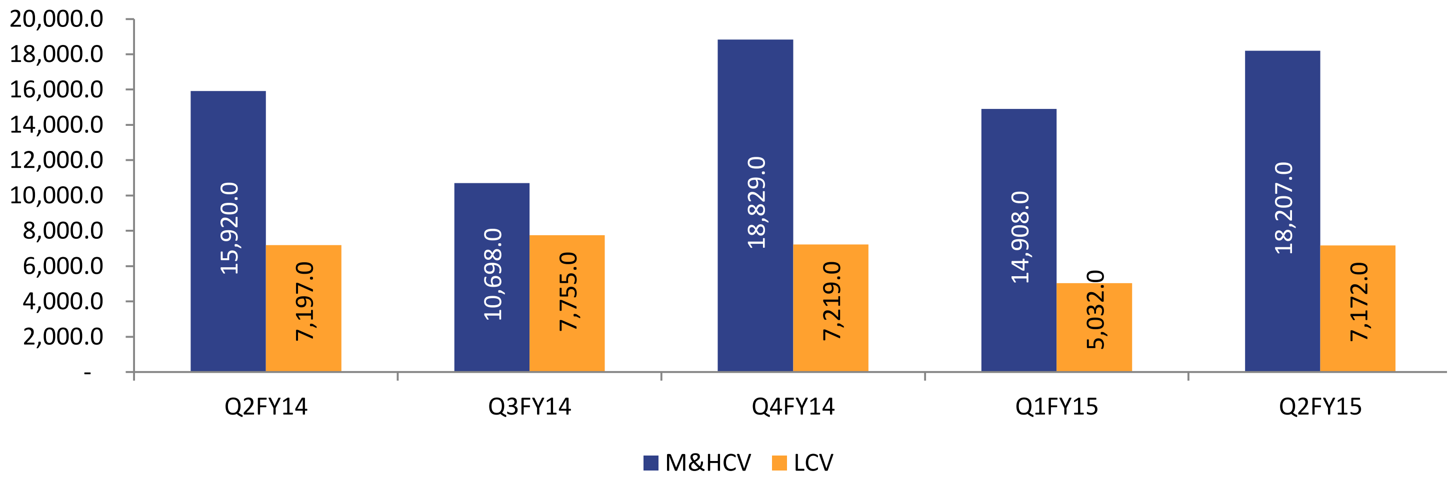
During H1FY15, earnings before interest, tax and depreciation (EBITDA) has grown sharply by 340.6% YoY to ₹3,504.8 mn on account of higher sales growth in M&HCV segment. Further the EBITDA margin improved sharply by 460bps to 6.2% in H1FY15 as against 1.6% in H1FY14.

Management expects that mining related sales (tippers) should see revival when industrial activity picks up. Industrial activity in India has shown initial sign of revival.

Increase in sales volume – Initial signs of revival

Ashok Leyland's total sales volume grew by 9.8% YoY to 25,379 units during Q2FY15 as against 23,117 units during Q2FY14. The growth in sales volume were led by medium and heavy commercial vehicles sales, which were up 14.4% YoY to 18,207 units during Q2FY15, while the LCV segment sales volume remain flat at 7,172 during the said period. One of the reasons the company outperformed the sector was the higher sales in the southern part of the country. Further, higher sales of tractor trailers drove the volumes in the higher tonnage segment but the company indicated that mining related sales (tippers) should see revival once industrial activity picks up and industrial activity already show initial sign of recovery. The management highlighted that currently the replacement demand is driving volumes and is hoping fresh orders will pick up pace in the coming months.

Sales Volume Trend (in Units)



The company's market share in M&HCV rose by 1.7% to 27.1% in H1FY15.

The management highlighted that its International operations grew by 25%, while sales of defence vehicles also registered a healthy growth.

For the first half of current fiscal (H1FY15), the company witnessed marginal uptick in its sales volume supported by growth in M&HCV volumes. The company sold 44,841 units as against 45,319 units in a year ago period, helped by 7.4% YoY growth in M&HCV sales. Moreover, the company's market share in M&HCV rose by 1.7% to 27.1% as in September 2014. The sales of Light Commercial vehicles (LCV) stood at 12,204 units in H1FY15 as against 14,021 units in H1FY14 and reported a decline of 13.0% YoY. Further the management highlighted that its International operations grew by 25%, while sales of defence vehicles also registered a healthy growth.

The management indicated that volumes should pick up in the second half of 2015. Some of the key indicators which aid demand are favourable such as freight rates. The cost of transporting goods has increased in the April to August period and is a positive for the CV segment of Auto Industry. Combined with a lower cost of operating a vehicle given falling fuel costs makes it attractive for fleet owners to replace/order fresh vehicles.

To de-risking its portfolio, company focused towards export market and LCV segment

In order to maintain its growth trajectory, the company is aiming to boost exports. Buoyed by 25% growth in its overseas operations in the first half of this fiscal, Ashok Leyland is now

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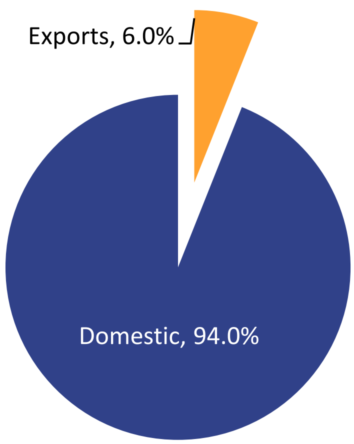
working on a strategy to expand exports and eyeing to get one-third of its total revenues from exports. Noting that the company is currently serving Bangladesh, Sri Lanka and the Middle East, the management highlighted that the three markets together accounts for 80% of the total exports. The company had shipped 2,735 vehicles to the three overseas regions during the H1FY15 as against 1,953 units during corresponding period a year ago, registered a robust growth of 40.0% during the said period. Besides targeting the three markets, the company is also looking at entering newer geographies including Africa, South America and South East Asian markets.

Further, to de-risk its portfolio which is more inclined towards M&HCV segment (cyclical in nature), the company is seeking higher growth in non-truck commercial products. The company launch of "DOST" in the LCV segment proved as the game changer in the LCV segment and taken LCV segment contribution to 32.5% of the total sales at the end of FY14. Further, according to reports, the company is expecting its joint venture with Nissan for LCV to turn profitable in the next three years. The company remains committed towards introducing more variants and products that will drive future volumes growth.

Sales Volume Distribution in FY14



Plans to sell its non-core assets to reduce debt likely to show good numbers in the coming quarters

In order to strengthen its financial leverage, Ashok Leyland is actively looking to sell stakes in its overseas subsidiaries Albonair GmbH (also Albonair India) and Avia Ashok Leyland Motors Ltd to lower down its debt.

Ashok Leyland remains committed towards lowering its debt burden and has managed to bring down its total debt to ₹36,979.7 mn in H1FY15, while it was ₹38,839.1 mn in FY14, which were partly funded through funds raised from qualified institutional investors placement in the current fiscal. Further, to strengthen its financial leverage, Ashok Leyland is actively looking to sell stakes in its overseas subsidiaries Albonair GmbH (also Albonair India) and Avia Ashok Leyland Motors Ltd to lower down its debt. The company is in the process of identifying suitable buyers to sell its non-core assets. The sale of stakes in subsidiaries is expected to improve the financial situation of the company.

Albonair is a German company which is a complete solution provider for reducing the automotive emissions and has presence in both passenger and commercial vehicle sectors globally. While, Avia Ashok Leyland Motors Ltd. is a Czech subsidiary which specializes in trucks. The Ashok Leyland Boss range of intermediate commercial vehicles which is being manufactured at the company's Pantnagar facility is derived from Avia. The sale of Avia is not expected to affect the Boss-related technology rights that Ashok Leyland has access to.

The company has been sharply focused on reducing working capital and lowering debt. We expect company's efforts to lower down it debt will improve company's profitability in the company quarters.

Well positioned to grow at a faster pace than Industry growth

The management is confident to outpace industry growth owing to gains in overall market share and sharper growth in the southern market.

The company expects that the CV industry volume to grow in the range of 5-10% in FY15 and is confident to outpace industry growth owing to gains in overall market share and sharper growth in the southern market. Ashok Leyland managed to regain its lost market share during H1FY15 to 27.1% as compared to 25.8% in FY14. This growth in the market share was driven by stronger growth in Southern markets. We believe that the stronger growth in higher tonnage segments (where Ashok Leyland has higher market share) will also help the company to further gain market share. Going ahead, we expect Ashok Leyland to sustain its market share at around current levels and will gain further in the longer term.

Ashok Leyland being the second largest player in the industry continues to face challenges on two counts - Slowing demand as industrial activity levels which declined in the past two years and increasing competitive pressures from newer players. Along with a volume decline, realisations have also suffered as discounts reached untenable levels.

However, with a stable and reform-oriented government, we expect a sharp revival in MHCV industry volumes over the next 2-3 years and Ashok Leyland is in a much more comfortable situation to grow at a faster pace than industry.

Key Risks

- Weaker than expected recovery in CV volumes especially the MHCV volumes.
- Lower than expected improvement in margin due to heavy discounts.
- Any unexpected increase in debt burden.
- High Inflation, High Interest rates.

Balance Sheet (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Share Capital	2,660.7	2,660.7	2,845.9	2,845.9
Reserve and surplus	41,890.4	41,818.2	49,736.8	52,230.7
Net Worth	**44,551.0**	**44,478.8**	**52,582.7**	**55,076.6**
Loan funds	35,048.2	38,839.1	36,254.6	34,672.3
Provisions	3,872.0	1,559.9	1,562.4	1,707.7
Deferred tax liability (net)	5,273.7	4,067.7	4,288.1	4,288.1
Current Liabilities	42,204.3	39,110.7	40,942.0	47,582.5
Other long term Liabilities	17.8	23.7	29.8	29.8
Total Equity & Liabilities	**130,967.0**	**128,080.0**	**135,659.6**	**143,357.0**
Fixed assets	59,708.1	58,413.9	59,797.9	62,787.8
Loans & advances	13,706.8	14,734.8	15,301.5	18,514.8
Investments	23,376.3	27,896.9	28,556.1	26,948.5
Current Assets	34,055.5	26,703.5	31,867.9	34,969.7
Other long term assets	120.3	330.9	136.2	136.2
Total Assets	**130,967.0**	**128,080.0**	**135,659.6**	**143,357.0**

Profit & Loss Account (Standalone)

Y/E (₹mn)	FY13A	FY14A	FY15E	FY16E
Total Income	**124,812.0**	**99,434.3**	**121,178.7**	**148,357.4**
Expenses	116,047.3	97,768.6	112,453.9	135,005.2
EBITDA	**8,764.7**	**1,665.6**	**8,724.9**	**13,352.2**
Other Income	623.5	665.2	976.3	976.3
Depreciation	3,807.8	3,770.4	4,147.4	4,562.1
EBIT	**5,580.4**	**(1,439.5)**	**5,553.8**	**9,766.3**
Interest	3,768.9	4,529.2	4,117.5	3,743.2
PBT (before exceptional item)	**1,811.5**	**(5,968.8)**	**1,436.3**	**6,023.2**
Exceptional item	2,895.6	5,056.6	1,089.7	0.0
PBT (after exceptional item)	**4,707.1**	**(912.2)**	**2,526.0**	**6,023.2**
Tax	370.0	(1,206.0)	916.9	2,186.4
Net Profit	**4,337.1**	**293.8**	**1,609.0**	**3,836.7**

Key Ratios (Standalone)

Y/E	FY13A	FY14A	FY15E	FY16E
EBITDA Margin (%)	7.0	1.7	7.2	9.0
EBIT Margin (%)	4.5	(1.4)	4.6	6.6
NPM (%)	3.5	0.3	1.3	2.6
ROCE (%)	7.2	(1.8)	6.5	11.2
ROE (%)	9.7	0.7	3.1	7.0
EPS (₹)	1.6	0.1	0.6	1.3
P/E (x)	31.7	468.2	91.4	38.3
BVPS (₹)	16.7	16.7	18.5	19.4
P/BVPS (x)	3.1	3.1	2.8	2.7
EV/Operating Income (x)	1.4	1.8	1.4	1.2
EV/EBITDA (x)	19.7	105.8	19.8	12.8

Valuation and view

The management highlighted that the demand for CV likely to improve in the second half of FY15. Further the plans to lower down the discounts currently offered to boost sales volume. Moreover, the company has been able to take price hikes during the past quarters to offset the discounts. Besides, the company has laid focus on working capital management and accordingly lowered its working capital requirement. Going ahead, the positive operating leverage from volume growth will be beneficial to the margins. Further, the management highlighted that the cost control initiatives have already taken and expect some uptick in margins in the coming quarters.

At a current market price (CMP) of ₹52, the stock trades at an EV/EBITDA of 19.8x FY15E and 12.8x FY16E. We recommend 'BUY' with a target price of ₹62, which implies potential upside of ~20% to the CMP from long term perspective.

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