MORNING INSIGHT

kotak Kotak Securities

PRIVATE CLIENT RESEARCH

FEBRUARY 3, 2011

Economy News

- The Supreme Court on Thursday ordered the cancellation of all the 122 unified access service licences issued in January 2008 by former telecom minister A Raja. It also directed the Telecom Regulatory Authority of India (TRAI) to make fresh recommendations for the telecom spectrum auction route in future, within four months. (BS)

Corporate News

- **Fortis Healthcare** plans to hive off its non-core business and related assets into a separate company that is likely to be listed on the Singapore Stock Exchange as a business trust to raise about $300 million. The funds will be used for de-leveraging the balance sheet and to fuel future growth. (ET)
- **Escorts Ltd** has cut production and raised prices of tractors by Rs 7,000 in January to improve its profitability. The move is part of a multi-pronged strategy to preserve cash and reduce inventory levels. At present, the company can make 4,000-7,500 tractors a month across its Faridabad-based facilities. (BL)
- **Reliance Industries** has secured a $400-million equivalent loan from Italian export-credit agency SACE.SACE has granted loan to Reliance for the expansion and upgrading of the production capacity of its petrochemical plants, a gasification plant and refinery off-gas cracker as part of an investment plan in India worth over $11 billion. (ET)
- **Binani Industries** has acquired the Europe-based "3B - The Fibreglass Company" from the private equity firm Platinum Equity for €275 million. Headquartered in Battice, Belgium, 3B makes fibreglass for reinforcement of thermoplastics and thermoset polymer applications, and is a preferred supplier to global leaders in industries including automotive and wind energy. (BL)
- **GMR Infrastructure** is pursuing brownfield projects to augment revenues and boost cash flows. The economic slump has forced the company to rethink its strategy, assess risks and conduct stress tests on its portfolios to ensure project schedules are not compromised. (ET)
- Power generating companies and coal traders have welcomed **Coal India Limited (CIL)'s** move to withdraw rise in coal prices. CIL had raised coal prices under a new pricing mechanism, under which the prices were linked to the quality of coal. However, this was opposed by power, steel and cements firms. (BS)
- **Gillette India** has reported muted net profit growth at Rs199 mn for the quarter ended December 31,2011, primarily due to rupee devaluation and inflationary pressures. The company had posted a net profit of Rs200 mn in the same period last fiscal. (ET)
- **Apollo Hospitals** is planning to set up a hospital in Kerala with an investment of around Rs 1.5 bn. The group has also applied for regulatory approvals for some land to construct a hospital in north Chennai, which would have around 500 beds, involving an investment of Rs 2 bn. (BS)
- **NTPC** is in talks with **GAIL** for signing a long-term pact for sourcing imported gas for its plants. The company is in initial talks with GAIL for sourcing gas, provided it finds buyers for the electricity produced from those plants. (ET)

Source: ET = Economic Times, BS = Business Standard, FE = Financial Express, BL = Business Line, ToI: Times of India, BSE = Bombay Stock Exchange

Equity

	2 Feb 12	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Indian Indices				
SENSEX Index	17,432	0.8	12.3	(0.2)
NIFTY Index	5,270	0.7	13.7	0.2
BANKEX Index	11,480	0.5	25.1	2.2
BSET Index	5,860	1.5	0.6	1.5
BSETCG INDEX	10,232	1.3	26.3	(5.4)
BSEOIL INDEX	8,592	0.4	12.6	(4.1)
CNXMcap Index	7,226	0.5	18.5	0.1
BSESMCAP INDEX	6,609	0.5	18.9	(4.7)
World Indices				
Dow Jones	12,705	(0.1)	4.0	7.3
Nasdaq	2,860	0.4	9.8	8.3
FTSE	5,796	0.1	4.0	5.7
NIKKEI	8,877	0.8	4.8	2.6
HANGSENG	20,739	2.0	9.7	7.7

Value traded (Rs cr)

	2 Feb 12	% Chg - Day
Cash BSE	3,629	(24.2)
Cash NSE	18,566	10.4
Derivatives	120,751	24.7

Net inflows (Rs cr)

	1 Feb 12	% Chg	MTD	YTD
FII	2,093	224.4	2,093	13,182
Mutual Fund	185	90.6	185	(1,663)

FII open interest (Rs cr)

	1 Feb 12	% Chg
FII Index Futures	11,825	1.9
FII Index Options	33,900	4.2
FII Stock Futures	26,975	(0.5)
FII Stock Options	1,138	8.4

Advances / Declines (BSE)

2 Feb 12	A	B	T	Total	% total
Advances	127	1,100	344	1,571	53
Declines	77	968	249	1,294	43
Unchanged	1	89	36	126	4

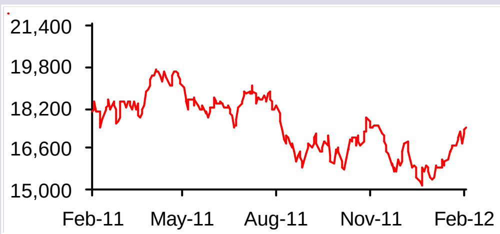
Commodity

		2 Feb 12	% Chg 1 Day	% Chg 1 Mth	% Chg 3 Mths
Crude (NYMEX)	(US$/BBL)	96.5	0.1	(6.3)	2.6
Gold	(US$/OZ)	1,755.3	0.6	9.9	(0.4)
Silver	(US$/OZ)	33.9	0.4	16.4	(0.8)

Debt / forex market

	2 Feb 12	1 Day	1 Mth	3 Mths
10 yr G-Sec yield %	8.13	8.14	8.39	8.90
Re/US$	49.2	49.3	53.3	49.2

Sensex



MARKET STRATEGY

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MARKET STRATEGY

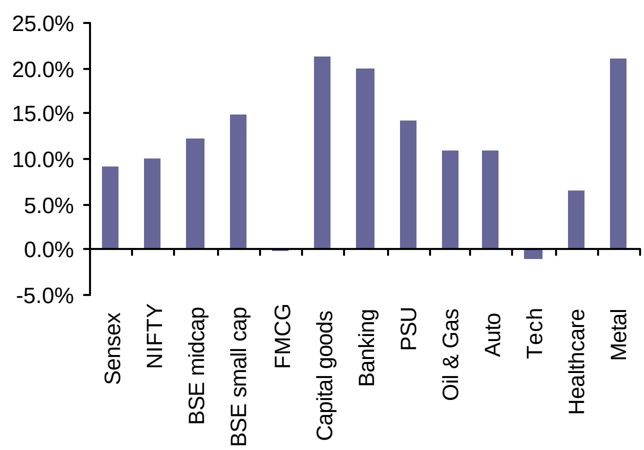
Global equities started the new year on a strong note on the back of resilient US economic data. Successful Spanish and Italian bond auctions aided the rally. Indian equities (up about 11% for the month) outperformed the developed market indices by a wide margin. Revival in FII flows, progress on reforms and softening of inflation led to a strong rally in the markets. The RBI cut the CRR ratio, which further fuelled the rally. Beaten-down sectors like Capital Goods, Real Estate and Banking emerged as the outperformers in the rally.

Economic data emerging from US remained healthy and there were signs that the labour market is finally gaining strength. Fed announced that it will likely hold interest rates near zero until at least 2014. In the Eurozone, the debt crisis continued to linger. Spain announced that it would miss its 2011 fiscal deficit target. The S&P downgraded France's sovereign rating. While the downgrade was an important event, markets were expecting it for some time and hence the market reaction was muted. A positive event was the successful auction of Spanish and Italian bonds. In the near-term, the Eurozone leaders are working towards averting an impending default by Greece.

On the domestic front, Government notified 100% FDI in single-brand retail, paving way for global chains like Adidas, Louis Vuitton and Gucci to have full ownership of their India operations. The government also initiated efforts to address power sector concerns in a time-bound manner. The markets were up also due to revival in FII flows coupled with softening inflation. FII flows were about $2bn (cash segment) for the month. Q3FY12 results have been largely in line with expectations.

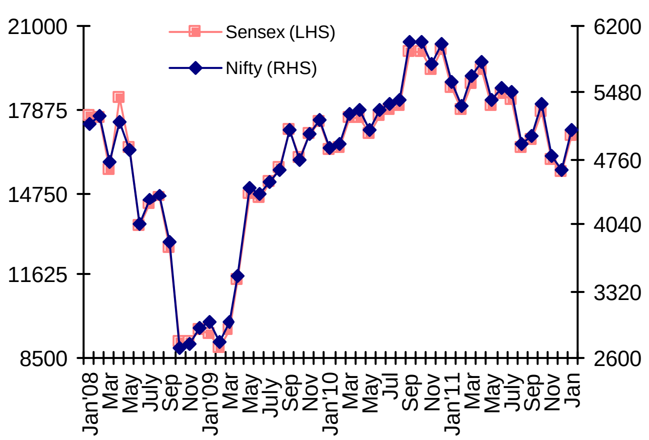
Post the rally, valuations are reasonable given the moderate growth outlook in near-term. Looking ahead, the developments in the Eurozone would be closely monitored. The geo-political developments related to Iran are also a matter of concern to us in that it may push crude oil prices upwards. There are assembly elections in a few states after which, the Union Budget would be presented in March. Post the strong rally in January, we expect markets to consolidate its gains. We recommend a bottoms-up approach with a medium to long term view. One should accumulate stocks of companies having ethical managements and strong balance sheets, which are available at reasonable valuations, across sectors like IT, Banking, Media, Logistics, Capital Goods and Infrastructure sectors.

Market performance - sector wise (Jan 2012)



Source: Bloomberg

Benchmark indices - India



Source: Bloomberg

Markets rallied on the back of strength in US economy and successful bond auctions

For the month, most major markets posted gains. Emerging economies outperformed the developed ones. Global markets commenced the new year on a strong note aided by continuing strength in US economic growth despite the ongoing crisis in the Eurozone. The data on consumer sales as well as purchasing manager's index were strong. The labour market also showed signs of vibrancy with monthly jobs data for December indicating an addition of 200,000 jobs. Unemployment rate declined to 8.5% for December. On the earnings front, tech stocks reported robust numbers for the quarter which helped the Nasdaq outperform the Dow Jones for the month. Fed announced that it will likely hold interest rates near zero until at least 2014. In a departure from past, the Fed announced setting an inflation target of 2%, when it released its economic forecast and said it will maintain its highly accommodative stance to support the recovery

In the Eurozone, the debt-crisis continued to linger. Spain announced that it would miss its 2011 fiscal deficit target. It has subsequently announced austerity measures to rein in expenditure. The S&P downgraded France's sovereign rating. While this was an important event, markets were expecting it for some time and hence the market reaction was muted. However, the downgrade pushed the yields on EFSF (bailout fund wherein France is a creditor) bond yields. A positive event was the successful auction of Spanish and Italian bonds. In the near-term, the Eurozone leaders would be working on putting in place a permanent rescue fund for the Euro Zone. The uncertainty over Greece continues as the nation has been negotiating with its private creditors (mainly hedge funds) for accepting higher hair-cuts on bond holdings.

On the economic front, the Eurozone economy continued to lose steam. China reported 8.9% growth in GDP, which was higher than market estimates.

Indian markets outperformed by a wide margin

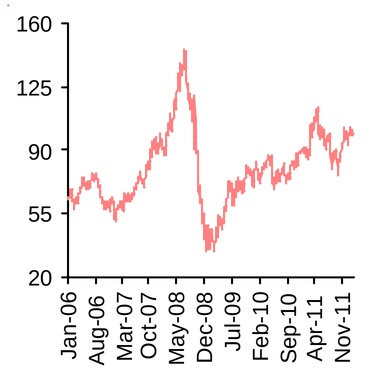
Performance of Indian equities in January mirrored the rally in the global equity indices. The Sensex was one of the major underperformers in 2011 but began the new year on a strong note. The Sensex rallied ~11% vs 8%, 3% and 11% for Nasdaq, Dow Jones and HSI respectively. Among individual sectors, the capital goods, real estate and banking indices rebounded strongly. Taking note of the beaten-down valuations, the FIIs bought indian equities. This also helped reverse the downward trend in the INR. The RBI cut the CRR ratio, which further fuelled the rally.

During the month, SEBI announced that promoters can now offload their stakes through Institutional Placement Programme (IPP) or sale of through stock exchange. This move is expected to enable corporates meet the minimum public holding guideline to be implemented from June 2013. Additionally, this move can also help government in meeting its disinvestment target by bypassing the lengthy process of a FPO.

This earnings season was widely expected to be tough given the impact of unfavourable global economy combined with domestic headwinds of high interest costs and forex fluctuation impact. Barring IT, most sectors were expected to report deterioration in profitability. In this backdrop, the earnings of frontline companies have not been disappointing and has been largely in-line.

Infosys headline numbers were in line with expectations but the company's revenue guidance for Q4 disappointed the street. The company noted that the moderation in revenue guidance indicated near-term uncertainty in client spending. TCS' 3Q operating results were in line with our expectations. However, the company was cautious about the pricing environment and conceded that decisions on discretionary budgets are being delayed.

Brent Crude (US$/bl)



Source: Bloomberg

While most banks reported decent numbers for Q3 FY12, Union Bank's numbers were disappointing. HDFC and HDFC Bank's numbers were robust and reported healthy NIMs accompanied by a stable asset quality. Axis Bank earnings were higher than expectations but reported higher slippages (net addition in NPAs). Bank of Baroda's headline numbers were strong but asset quality deteriorated marginally.

Led by strong exports, Bajaj Auto's 3QFY12 results were ahead of estimates. Hero Moto Corp's earnings came in slightly below expectation even as the revenues remained in line. Its profits during the quarter were aided to some extent by lower tax rate.

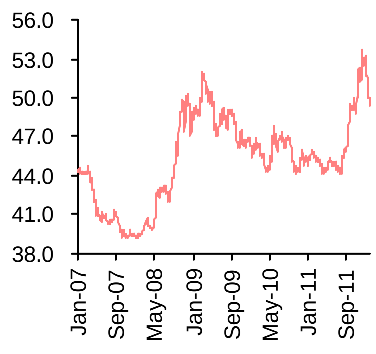
L&T PAT was ahead of expectations by a wide margin. However, the profit was led by significantly higher other income. Order intake was in line with expectations. The company maintained its order intake guidance for the year, a bold move we opine. BHEL's numbers were disappointing on the operations as well as order intake front.

Government takes initiatives to speed reforms

During the month, the Government notified 100% FDI in single-brand retail, paving way for global chains like Adidas, Louis Vuitton and Gucci to have full ownership of their India operations. The hike in FDI limit is subject to some conditions including 30% sourcing from India.

In another move, the government sought to address the issues that has crippled power sector. The PM met the heads of power utilities to address various concerns that are hampering the sector including fuel availability and health of SEBs. The PM constituted a committee of secretaries under Principal Secretary, Pulok Chatterjee to work out a time bound action plan to chalk out plans on coal and gas shortage, hike in power tariffs and unleashing second generation of power reforms.

Rupee/US$



Source: Bloomberg

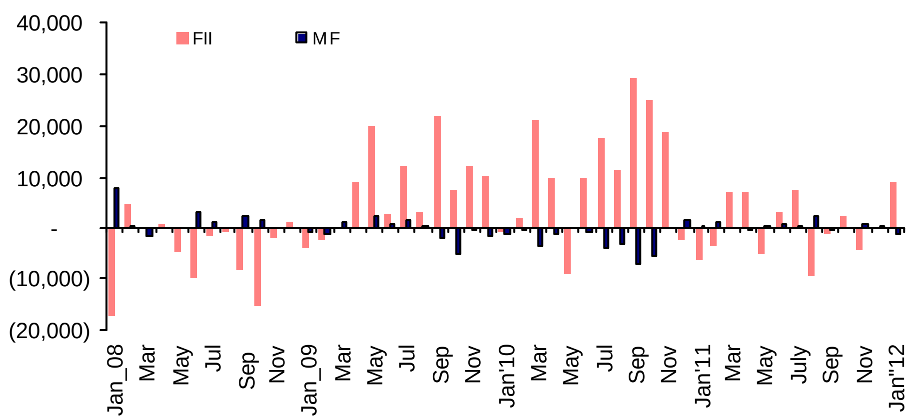
Declining trend in Rupee arrested

For the month, Rupee has gained 7.3% month-on-month vs the USD to close at Rs.49.4 (as on 31st Jan). The appreciation in INR has been primarily driven by revival in FII flows. The appreciation should come as a relief to importers as well as the various corporates that have borrowed in foreign currency. The appreciation in Rupee should also relieve pressure on imported inflation (primarily crude oil).

FIIs turn net buyers

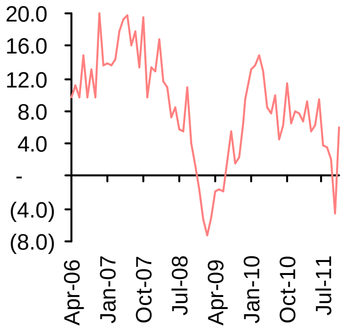
For the month, FIIs turned buyers after two consecutive months of net selling. For the month of January, FIIs were net buyers to the tune of Rs.110.9 bn. We note that FII flows remain one of the keys for the market to sustain gains. However, FII flows are influenced by global factors as well as domestic issues including inflation, progress on reforms, corporate governance and valuations.

FII & Mutual Fund investment (Rs Cr)



Source: Bloomberg

IIP growth (%)



Source: Bloomberg; Note: IIP growth since April 2009 has been recompiled using new series of WPI

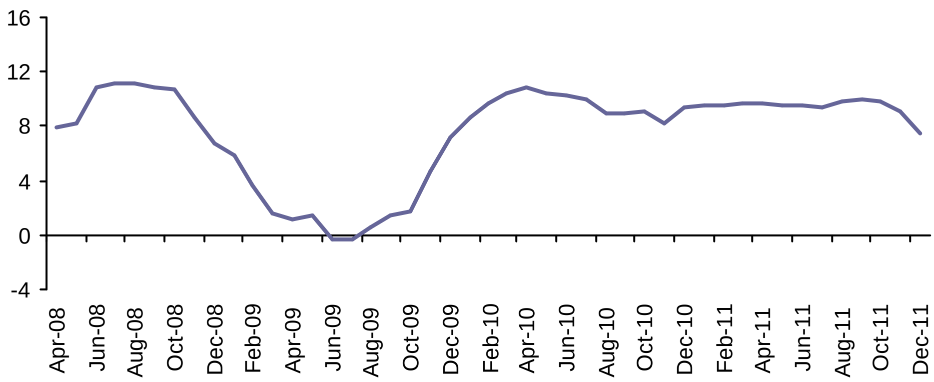
IIP rebounded in November on the back strong electricity production

IIP growth in November came in sharply higher than estimates at 5.9%, after recording 2 year low reading in October at -4.7% (revised slightly upwards from -5.1%). Cumulative growth during Apr-Nov FY12 has slowed to 3.8% vs 8.7% last year. Despite strong 9.5% growth in Electricity (wt. 10.32%), slowdown in manufacturing sector at 4.1% (wt. 75.53%) and contraction in mining sector at -2.5% (wt. 14.16%) brought down the industrial growth in Apr-Nov. 3MMA of IIP remained low at 1.07% vs. 3.03% in September. A sharp reversal in IIP from lows of October was not entirely unexpected, as indicated by the robust performance of core infrastructure sectors. The Eight Core Industries Index had grown by 6.75% in November 2011, with an upside in five out of eight industries.

Inflation softens led by primary articles

Headline WPI inflation in December decelerated sharply to 7.47% from 9.11% in November, one of the lowest in the past several months. The drop was due to fall in primary articles inflation (3.1% vs 8.5% in Nov 2011). Manufactured inflation continues to remain well entrenched at elevated levels, rising by 7.41%. Fuel inflation remains at a high of 15%. Additionally, October headline WPI inflation was revised to 9.87% from 9.73% previously.

Inflation (%)



Source: Bloomberg

Monetary policy - Cycle turns as the RBI cuts CRR

RBI has started its monetary policy easing with 50 bps cut in CRR to 5.5% from 6%, injecting Rs.320 billion of primary liquidity into the banking system. However, it has also indicated that, unless there is credible fiscal consolidation in the budget it would be constrained from lowering the rates. RBI revised the GDP forecast downward to 7% for FY12, but maintained the inflation forecast at 7% by March end. We expect reduction in repo and reverse repo rates to begin from the next policy meeting. The CRR cut by 50bps would inject Rs.320 bn of primary liquidity in the system and in turn partly alleviate the structural liquidity deficit witnessed in the banking system (Rs.1200 bn of average borrowing under LAF window). We believe this has to do more with the change in stance rather than easing of monetary policy; however, RBI has given enough indications of softer bias in coming months.

Recommendation

The Sensex was up around ~ 11% in January 2012 on revival in FII flows coupled with softening inflation and government's policy initiatives. Q3FY12 results have been largely in line with expectations. Post the rally, valuations are reasonable given the moderate growth outlook in near-term. Looking ahead, the developments in the Eurozone would be closely monitored. The geo-political developments related to Iran are also a matter of concern to us in that it may push crude oil prices upwards. There are assembly elections in couple of states after which the Union Budget would be placed in March. Post the strong rally in January, we expect markets to consolidate its gains. Inflation has begun to soften and if the trend continues then it may provide room for the RBI to effect further cuts. We recommend a bottoms-up approach with a medium to long term view. One should accumulate stocks of companies having ethical managements and strong balance sheets, which are available at reasonable valuations, across sectors like IT, Banking, Media, Logistics, Capital Goods and Infrastructure sectors.

Preferred picks

Sector	Stocks
Automobiles	Bajaj Auto
Banking	HDFC Bank, ICICI Bank, Bank of Baroda, SBI
Cement	Grasim Industries
Construction	IRB Infra, Unity Infra
Engineering	Greaves Cotton, Cummins, BEL, Havells
FMCG	GCPL
Information Technology	Infosys, TCS, KPIT, NIIT Tech
Logistics & Transportation	Allcargo Global Logistics, Gateway Distriparks, Mundra Port, Arshiya International
Media	HT Media
NBFC	IDFC, M&M Financial Services
Oil & Gas	Cairn India, IGL

Source: Kotak Securities - Private Client Research

INITIATING COVERAGE

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PHOENIX MILLS LTD (PML)

PRICE: RS.174 **RECOMMENDATION: BUY**
TARGET PRICE: RS.236 **FY13E P/E: 19.2x**

Phoenix Mills ltd (PML) has emerged as a key beneficiary of growing demand in the retail sector with its flagship premium mall High Street Phoenix (HSP) located in prime area of central Mumbai. HSP has become a cash cow for Phoenix mills with its retail-led mixed use format spread across nearly 0.9 mn sq ft. Its lease model along with revenue sharing enables the company to earn a stable revenue stream which is linked to the consumption patterns witnessed in respective retail outlets. Phoenix Mills Ltd is replicating the model of HSP in the format of market cities with a mix of retail, commercial and residential segments. With its expertise in managing mixed use retail assets, we expect company to benefit from rising consumption levels in cities like Pune, Bangalore, Mumbai and Chennai. Along with this, company has also ventured into other cities through its investment in players like Entertainment World Developers Ltd and Big Apple Real estate Ltd.

We expect PML to benefit from improvement in occupancies in HSP, rent negotiations with its anchor clients at higher rates as well as commencement of rentals at market cities during FY12. PML's hospitality venture Shangri-La is also expected to begin operations by Q1FY13 which is also likely to increase overall footfalls for HSP. We thus expect consolidated revenues to grow at a CAGR of 58% between FY10-FY13. Operating margins on consolidated basis are likely to remain high, though lower than standalone HSP. Net profit growth going forward is expected to be impacted by higher interest and depreciation on commissioning of market cities operations. We thus expect net profits to grow at a CAGR of 28% between FY10-FY13.

At current price of Rs.174, stock is trading at 24.5x and 19.2x P/E and 18.7x and 11.7x EV/EBITDA on FY12 and FY13 estimates. We value the company on sum-of-the-parts valuation methodology and arrive at a target price of Rs.236 on FY13 estimates. We are positive on the company due to its robust business model, excellent operating cash flows from HSP and expertise to capitalize on the upcoming opportunities in the retail sector in various cities. We thus recommend BUY on the stock.

Stock details

BSE code	:	503100
NSE code	:	PHOENIXLTD
Market cap (Rs mn)	:	25,204
Free float (%)	:	34.1
52 wk Hi/Lo (Rs)	:	229/149
Avg daily volume	:	68500
Shares (o/s) (mn)	:	144.85

Summary table (Consolidated)

(Rs mn)	FY11	FY12E	FY13E
Sales	2,102	3,099	4,927
Growth (%)	71.0	47.0	59.0
EBITDA	1,406	2,002	3,172
EBITDA margin (%)	66.9	64.6	64.4
Net profit	842	1,030	1,310
Net debt	8,605	12,261	11,916
EPS (Rs)	5.8	7.1	9.0
DPS (Rs)	1.8	1.8	1.8
ROE (%)	5.1	6.0	7.3
ROCE (%)	5.6	6.6	8.5
EV/Sales (x)	16.2	12.1	7.6
EV/EBITDA (x)	24.2	18.8	11.7
P/E (x)	30.1	24.6	19.4
P/BV (x)	1.5	1.5	1.4

Source: Company, Kotak Securities - Private Client Research

Key investment argument

- **Phoenix mills holds quality rental portfolio.** Company holds high quality rental portfolio mainly comprising of High Street Phoenix located in prime area of central Mumbai. With launch of international brands, it has emerged as Mumbai's premier lifestyle destination with footfalls of more than 1.5 mn every month. Rentals from HSP have been witnessing improvement due to rent negotiation with its anchor clients as well as with launch of Palladium. Rent based on revenue share model has also aided improvement in overall rentals. We expect high street phoenix's revenues on a standalone basis to grow to Rs 2.1 bn by FY13 from Rs 1.1 bn in FY10.

- **Rental revenues to improve with launch of new market cities.** Company is replicating the model of HSP in the format of market cities with a mix of retail, commercial and residential such as Pune Market City, Mumbai Market City, Chennai Market City and Bangalore Market City. Some of these market cities have already been launched during FY12. Thus, retail portfolio of the company is expected to increase 6 fold from 0.9mn sq ft from HSP currently to 5.3 mn sq ft including all market cities.

- **Residential launches to ease debt levels of market cities.** Residential launches are expected from Bangalore market city in next 6 months. Soft launch has already commenced from Chennai market city. These launches are expected to bring down the debt levels in market cities and would also be used for second phase of launches.
- **Venture into other cities through EWDL and BARE.** Apart from its presence in tier 1 cities such as Mumbai, Chennai, Bangalore and Pune, Phoenix mills has also increased its presence in other cities such as Indore, Nanded, Lucknow, Bareilly etc through its stake in Entertainment World Developers Ltd (EWDL) and Big Apple Real Estate Pvt Ltd (BARE). EWDL is developing approximately 23 mn sq ft through 14 projects in 11 cities. Through BARE, Phoenix mills is expanding its footprint in north Indian cities under Phoenix United brand.
- **Industry scenario remains stable for retail rentals in key cities.** Rentals have already corrected from the peak levels seen during Q2FY09 and prompted the retailers to move towards a revenue sharing model. Rents have likely found support at the current levels and there is low risk of downside from the current levels despite upcoming supplies due to higher occupancy levels expected in the new quality malls.
- **Launch of Shangri la to increase footfalls in High Street Phoenix.** Phoenix mills hospitality venture The Shangri-La, five star deluxe hotel is expected to be launched by Mar, 2012 or Q1FY13. Hotel will have 410 rooms and 23 serviced apartments and will compete with Four Seasons and ITC located in the near vicinity. Though in near term, hospitality venture may not be profitable due to relatively lower occupancy levels, but we expect footfalls for High Street Phoenix to witness an increase.
- **Revenues to jump in FY13 on a consolidated basis.** Phoenix mills has a majority holding in Pune market city, Bangalore residential project and BARE. With launch of Pune market city at the end of Q1FY12, we expect consolidated revenues to witness an increase on account of rental income and proceeds from commercial project revenue booking during FY12. Revenues are likely to increase further in FY13 due to higher occupancy levels in Pune market city, launch of residential project in Bangalore and higher revenues from Big Apple. We thus expect consolidated revenues to jump to Rs 3.1 bn in FY12 and Rs 4.9 bn in FY13.
- **Return ratios to improve going forward.** Phoenix mills', being an asset heavy model, has lower return ratios - RoE and RoCE. Its RoE and RoCE are expected to improve to 7.3% and 8.5% respectively for FY13 as against 4% and 3.9% respectively seen in FY10. Company would also have a comfortable leverage on a consolidated basis and its D/E would still remain comfortable even after it increases to 0.7x and 0.8x in FY12 and FY13 respectively.
- **Potential triggers of project launches.** Phoenix mills will be launching market cities and Shangri-La over next 3 months time frame. Along with this, EWDL and BARE would also be launching their retail projects during Oct, 11 to Jun, 12. Thus there is a strong visibility of project pipeline being delivered in next 18-24 months even after taking into account a few months delay in each of these projects.

Valuations

Stock is currently trading at 24.5x and 19.2x P/E on FY12 and FY13 estimates respectively. We have valued the company on DCF basis taking into account valuations of high street phoenix and other market cities separately. We arrive at a target price of Rs.236 on FY13 based on sum of the parts valuations methodology and recommend BUY on the stock.

Key risks and concerns

- **Oversupply in retail and commercial may keep rentals subdued.** Though rentals have stabilized at the current levels in the commercial and retail segment, but oversupply in any of these may result in higher vacancy levels.
- **Delay in launching market cities may impact rental collections.** Delay in launching the market cities may impact rental collections as well as share of profit from these for the company.
- **Minority stake in market cities may expose company to risk of exits by other investors.** Phoenix mills hold minority stake in Mumbai (Kurla) market city, Chennai Market city and Bangalore market city. It thus risks the company to exits by other investors.
- **Hospitality business is a drag on overall profitability.** Company has invested in hospitality business through Shangri La and hotel project in Agra. Hotel business may not be profitable in the near term due to higher costs involved.
- **Increase in interest rates may impact consumption patterns.** Any sharp increase in interest rates from the current levels can impact the consumption pattern which in turn would be negative for the retail sector.

RESULT UPDATE

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ASHOK LEYLAND

PRICE: RS.27 **RECOMMENDATION: REDUCE**
TARGET PRICE: RS.27 **FY13E P/E: 10.1X**

- **ALL's 3QFY12 results came in below our and street expectations. While revenues came largely as anticipated, EBITDA margin came in sharply below our expectations.**
- **Various one-time operating costs led to sharp increase in employee cost and other expenses. Even after taking those into account, the EBITDA margins were below expectations leading to profitability coming in way below our and consensus estimates.**
- **Going forward, the company expects its volumes to grow by 6% in FY12 and FY13. While margins are expected to improve, we expect the same to be under pressure in the near term.**
- **On the back of lower than expected results and rising cost, we are lowering our FY12 and FY13 earnings estimate. Our revised earning estimate stands lower by 17.6% and 3.8% for FY12 and FY12 respectively.**
- **At the CMP of Rs27, the stock trades at 10.1x its estimated FY13 earnings of Rs27 per share. We lower our target price to Rs27 (earlier Rs28) and continue with our REDUCE rating on the stock.**

Summary table

(Rs mn)	FY11	FY12E	FY13E
Sales	111,177	120,518	138,610
Growth (%)	53.5	8.4	15.0
EBITDA	12,176	11,447	14,805
EBITDA margin (%)	11.0	9.5	10.7
PBT	8,018	5,957	8,711
Net profit	6,313	4,885	7,143
EPS (Rs)	2.4	1.8	2.7
Growth (%)	49.0	(22.6)	46.2
CEPS (Rs)	3.4	3.1	4.1
Book value (Rs/share)	14.9	15.8	17.6
Dividend / share (Rs)	1.0	0.8	0.8
ROE (%)	16.6	12.0	16.0
ROCE (%)	14.7	10.9	13.9
Net cash (debt)	(23,887)	(30,091)	(30,133)
NW Capital (Days)	16.7	11.7	8.6
P/E (x)	11.4	14.7	10.1
P/BV (x)	1.8	1.7	1.5
EV/Sales (x)	0.9	0.8	0.7
EV/EBITDA (x)	7.9	8.9	6.9

Source: Company, Kotak Securities - Private Client Research

Quarterly performance

(Rs mn)	3QFY12	3QFY11	YoY (%)	2QFY12	QoQ (%)
Total Revenues	**28,798**	**22,272**	**29.3**	**30,946**	**(6.9)**
Total expenditure	26,694	20,352	31.2	27,634	(3.4)
RM consumed	21,288	16,294	30.6	22,757	(6.5)
Employee cost	2,723	2,179	25.0	2,515	8.3
Other expenses	2,683	1,879	42.8	2,362	13.6
EBITDA	**2,104**	**1,920**	**9.6**	**3,312**	**(36.5)**
EBITDA margin (%)	7.3	8.6	-	10.7	-
Depreciation	866	647	33.9	859	0.8
Interest cost	550	475	15.9	627	(12)
Other Income	32	17	93.2	103	(68.7)
Extraordinary income/ (loss)	-	(260)	-	-	-
PBT	**720**	**555**	**29.6**	**1,929**	**(62.7)**
PBT margins (%)	2.5	2.5	-	6.2	-
Tax	51	122	(58.4)	388	(86.9)
Tax rate (%)	7.0	21.9	-	20.1	-
Reported PAT	**669**	**434**	**54.3**	**1,541**	**(56.6)**
PAT margins (%)	2.3	1.9	-	5.0	-
Reported EPS (Rs)	**0.3**	**0.2**	**54.3**	**0.6**	**(56.6)**

Source: Company

Revenues came largely on expected lines

- ALL's 3QFY12 revenues at Rs28,798mn was in line with our estimate of Rs29,043mn.
- Revenues grew by 29% YoY largely on account of YoY 20% increase in volumes.
- For the quarter industry volumes in the bus segment remained weak on account of lower off take from the STU's whereas truck segment reported growth.

- Volumes in the tractor trailer and multi axle vehicle segment saw weakness; tipper segment registered a strong growth.
- ALL largely maintained its market share during the quarter except for the tractor trailer segment in the northern region.
- Spare parts sale during the quarter was at Rs1,850mn as against Rs1,600mn in 3QFY11. Similarly sales to defence establishments increased from Rs650mn in 3QFY11 to Rs850mn in 3QFY12.
- Company took a price increase of around 1-2% in January. ALL also effected a price hike in engine division and export markets.
- Company expects to sell close to 100,000 units in FY12 and grow by 6% in FY13. In our assumptions we have factored in flat growth for FY12 and 10% growth in FY13. In absolute numbers, our volume assumption stands slightly lower to the company's guidance.

Rise in cost severely dents EBITDA margin during the quarter

- Increase in cost across overheads severely impacted EBITDA during the quarter. Despite 29% growth in revenues, EBITDA grew by only 10% from Rs1,920mn in 3QFY11 to 2,104mn for the quarter under consideration.
- Sequentially EBITDA was down by 36.5%.
- Increased purchase of traded goods on account of purchase of Dost (LCV) from the Nissan-Leyland JV led to increase in raw material cost as a % of sales from 73.5% in 2QFY12 to 73.9% in 3QFY12. Management expects an impact of ~50bps on the margins on account of this arrangement with the JV.
- Employee cost at Rs2,723mn was higher by 25% YoY and 8.3% QoQ. Reasons of increase in employee cost includes 1.Bonus payment to employees to the tune of Rs160mn and 2.Increase in head count at the executive level primarily at the Uttarakand plant increased the cost by Rs80mn. While the bonus payment is annual exercise, rise of Rs80mn is recurring in nature.
- Other expenses increased sharply during the quarter from Rs1,879mn in 3QFY11 to Rs2,683mn in 3QFY12, a YoY growth of 43%. Sequentially too, other expenses were higher by 14%. Reasons for the same include 1.Higher number of annual maintenance contract serviced during the quarter costing Rs200mn to the company 2.Exchange loss of Rs150mn and 3.Substantial increase in marketing spend to the tune of Rs70mn.
- Company modified the method of amortization of value of leasehold land and that lead to a write back of Rs94.6mn under other expenses.
- On account of above mentioned reasons, the company witnessed a steep fall in EBITDA margin from 8.6% in 3QFY11 and 10.7% in 2QFY12 to 7.3% in 3QFY12. Even after factoring for the one-time expenses, EBITDA margins were disappointing.
- Going ahead, some of these expenses are not expected to be repeated, that will lead to sequential improvement in margins. However we expect the margins to remain under pressure in the near term due to subdued demand outlook and rise in cost overheads.

Profits came in below expectations due to poor operating performance

- Poor operating performance led to net profits coming in way below our and consensus expectations. ALL reported net profit of Rs669mn as against expected Rs1,270mn.
- Depreciation remained similar to 2QFY12 levels at Rs866mn. However, increase in capex led to 34% YoY increase in depreciation.

- Interest cost increased YoY from Rs475mn to Rs550mn on account of rising interest rate and increase in loans. Sequentially though interest cost was lower by 12%.
- Tax rate at 7% came in lower due to rise in R&D capital expenditure MAT credit taken during the quarter.

Conference call highlights

- Company expects the volumes in FY12 to grow by 6% and by 4-6% in FY13.
- Uttarakand plant produced 2,570 units in January 2012 and the company expects to increase production to 4,000 units on a monthly basis by March 2012. April 2011 - January 2012 production from this plant stands at 22,130 units.
- Inventory levels during the quarter declined from 9500 units in 2QFY12 to 9,000 units. Further the company said that dealers inventory remains in line with historical levels.
- ALL has witnessed some revival in the Southern market in January 2012.
- Discounts during 3QFY12 were at significantly higher levels.
- ALL has invested ~Rs3.5bn in capex YTD and expects full year capex to be around Rs5.5-6.0bn. Investments in JV YTD stands at Rs1.5bn and for the full year it is expected to be around Rs2.5-3.5bn.
- Debt as at end of 3QFY12 stood at Rs41bn that consist of Rs31bn as long term and Rs10bn towards working capital. Company expects to bring the working capital loan to Rs5bn by the end of 4QFY12.

Change in estimates

- On the back of lower than expected earnings and increase in employee and other expenses, we are lowering our FY12 and FY13 estimates.
- For FY12, we are marginally lowering our revenues by 1.8%. However due to poor 3QFY12 results we are lowering our estimates from 10.5% to 9.5% leading 17.6% drop in earnings from our previous estimates.
- We are keeping are revenues unchanged for FY13 but lowering our EBITDA margin estimate from 11.2% to 10.7% leading to factor in rise in staff cost and other expenses. Accordingly our revised net profit estimate stands lower by 3.8%.

Change in estimates

	FY12			FY13		
(Rs mn)	Old	New	% chg	Old	New	% chg
Revenues	122,735	120,518	(1.8)	138,610	138,610	0.0
EBITDA margin (%)	10.5	9.5	-	11.2	10.7	-
PAT	5,932	4,885	(17.6)	7,427	7,143	(3.8)

Source: Kotak Securities - Private Client Research

Valuation

We recommend REDUCE on Ashok Leyland with a price target of Rs.27

- At the CMP of Rs27, the stock trades at 10.1x its estimated FY13 earnings of Rs2.7 per share.
- Due to cutting down of our FY13 earnings estimate we are lowering our target price to Rs27 (earlier Rs28).
- We continue to retain **REDUCE** rating on the stock.

Bulk deals

Trade details of bulk deals

Date	Scrip name	Name of client	Buy/ Sell	Quantity of shares	Avg. price (Rs)
2-Feb	8K Miles Soft	Ravi Pukhraj Surana	S	29,300	58.4
2-Feb	Beryl Drugs	Jabeen Tradelink Pvt Ltd	B	34,500	18.3
2-Feb	Cubical Fin	The Hindustan Times Ltd	S	80,000	36.6
2-Feb	Cupid Trades	Inventure Growth & Securities Ltd.	B	12,000	201.7
2-Feb	Cupid Trades	Jimit Umesh Shah	B	8,000	201.7
2-Feb	Cupid Trades	Pravinbhai Mohanbhai Kheni	S	25,854	201.7
2-Feb	Dhvanil Chem	Somaiya Manoj Premjibhai	B	77,000	37.7
2-Feb	Dhvanil Chem	Arsenal Finstock Services Pvt Ltd	B	40,000	37.8
2-Feb	Dhvanil Chem	Vajiben Nathabhai Lunagariya	B	43,437	37.8
2-Feb	Dhvanil Chem	Dharmesh Bhailal Vaghela	S	59,729	37.6
2-Feb	Dhvanil Chem	Ashvin Balvantrai Vairagi	S	40,449	37.7
2-Feb	Dhvanil Chem	Yatri Shirishbhai Raval	S	39,500	37.8
2-Feb	Dr Agarwals-$	Pat Financial Consultant Pvt Ltd	B	221,015	152.0
2-Feb	Dr Agarwals-$	Bharat Jayantilal Patel	S	220,715	152.0
2-Feb	Esaar India	Kemfin Services Pvt Ltd	B	77,900	207.0
2-Feb	Gflfin	Decor Securities Pvt Ltd	B	105,000	32.8
2-Feb	Gflfin	Msr Securitiess	S	30,000	32.8
2-Feb	Gflfin	Kalptaru Investments Private Ltd	S	50,000	32.8
2-Feb	GSS Infotech	Beaumaris Investments Ltd	B	195,000	52.0
2-Feb	GSS Infotech	Clearwater Cap Partners S Opp Fund	S	195,000	52.0
2-Feb	Kailash Ficom	Mahendra Gosar Gada	B	100,000	25.9
2-Feb	Kanchan Intl	Dharmendra Harilal Bhojak	B	31,421	84.6
2-Feb	Kanchan Intl	SLP Traders (Satish Vasant Ghone)	B	40,000	85.7
2-Feb	Kanchan Intl	Ramesh Dwarkadas Daga	B	21,390	85.3
2-Feb	Kanchan Intl	Prem Kumar Prem Kumar	S	30,000	84.5
2-Feb	Kanchan Intl	Suresh Laxman Patil	S	20,000	85.6
2-Feb	Kanchan Intl	Geetadevi Pratapsinh Jadhav	S	20,000	85.9
2-Feb	Karma Ind	Polymers Multi Trade Pvt Ltd	S	217,041	46.5
2-Feb	Liberty Phos	Liberty Urvarak Ltd	B	200,000	58.0
2-Feb	Liberty Phos	Anisha R. Dhanani	S	200,000	58.0
2-Feb	Niraj Cement	Niftys Technologies Pvt Ltd	B	65,787	22.7
2-Feb	Pasupati Fin	Rohnil Boradia	S	40,410	31.5
2-Feb	PFL Infotech	Manoj Jain HUF	B	64,197	55.1
2-Feb	PFL Infotech	Sagar Ratna Hotels Pvt Ltd	S	60,000	55.1
2-Feb	Rajeswari Found	Bhavesh Shantilal Trivedi	B	50,000	34.8
2-Feb	Rajeswari Found	Dipal Virendrakumar Patel	S	29,300	35.3
2-Feb	Ranklin Sol-$	Sree Lakshmi Mikkilineni	B	26,000	11.4
2-Feb	Ranklin Sol-$	Kanakavalli Tayaramma Mikkileneni	S	26,000	11.3
2-Feb	RCL Foods	Primex	S	27,624	32.7
2-Feb	Regency Trust	Sandeepkumar Moolchand Fagania	S	65,000	41.9
2-Feb	Transchem-$	Prerna Healthcare Pvt Ltd	B	87,067	15.0
2-Feb	Transchem-$	Grandeur Corporation Ltd	S	90,000	15.0
2-Feb	Valecha Engr-$	Atul U Rege HUF	B	147,500	72.0
2-Feb	Vikas Wsp	Vision Millenium Exports Pvt Ltd	S	860,000	32.3

Source: BSE

Gainers & Losers

Nifty Gainers & Losers

	Price (Rs)	chg (%)	Index points	Volume (mn)
Gainers				
Bharti Airtel	386	6.8	9.7	25.3
ICICI Bank	902	1.4	4.7	8.5
TCS	1,148	1.7	3.2	1.7
Losers				
ITC	199	(1.3)	(4.5)	7.3
IDFC	131	(4.7)	(2.5)	17.4
DRL	1,632	(2.7)	(1.9)	0.7

Source: Bloomberg

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