Sharekhan by BNP PARIBAS

Ashok Leyland

Long road to recovery

Sector: Automobiles
Result Update

	Change
Reco: **Hold**	↔
CMP: **Rs. 52**	
Price Target: **Rs. 60**	↑

↑ Upgrade ↔ No change ↓ Downgrade

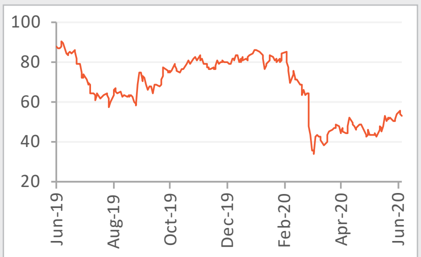
Company details

Market cap:	Rs. 15,367 cr
52-week high/low:	Rs. 91/34
NSE volume: (No of shares)	2.7 cr
BSE code:	500477
NSE code:	ASHOKLEY
Sharekhan code:	ASHOKLEY
Free float: (No of shares)	141.1 cr

Shareholding (%)

Promoters	51.5
FII	17.6
DII	15.1
Others	15.8

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	24.0	23.5	-32.8	-39.1
Relative to Sensex	12.7	5.6	-17.4	-28.0

Sharekhan Research, Bloomberg

Ashok Leyland Limited (ALL) posted mixed results for Q4FY20. ALL revenues (better realisations due to higher share of heavy trucks) and margins (due to vendor discounts and soft commodity) were ahead of our as well as street estimates. However, provisions for impairment in Optare Inc (subsidiary) investment to the tune of Rs 66 cr led to ALL posting higher than expected loss during the quarter. On account of contraction expected in India's economic growth in FY21 due to COVID-19, MHCV demand is expected to be severely impacted. We expect demand challenges to sustain in near term. While the trucking industry capacity has increased post the relaxation of the lockdown, demand continues to be under pressure which is likely to impact new truck sales. Normalcy in economic activity is still some time away, and we expect growth to recover in FY22 which would revive truck demand. Hence, we retain our Hold rating on the stock with revised PT of Rs 60.

Key positives

- ALL realisations grew marginally by 1% y-o-y in Q4FY20 and were better than estimates. Improved MHCV mix led to higher realisations
- ALL margins at 4.8% were better than estimates. Discounts received from vendors coupled with cost control initiatives led to better than expected margins.

Key negatives

- ALL realised impairment provision of Rs 66 cr in Q4FY20 on investment in subsidiary Optare Inc.
- ALL marginally lost market share in MHCV segment in FY20. ALL market share dropped 150 bps y-o-y to 31.8% in FY20.
- MHCV demand is expected to remain under pressure in near term on account of excess capacity in the system due to axle load norms and increased supply post lifting of lockdown.

Our Call

MHCV demand to remain under pressure in the near term; Retain Hold: MHCV demand is likely to remain under pressure in the near term driven by a drop in economic growth on account of COVID-19. We expect MHCV segment to report a drop over the next two to three quarters as economic growth would take time to reach normalcy. Recovery would take time as economic activity and consumer sentiment would improve gradually. ALL volumes are expected to drop sharply in FY21 as first two months of FY21 (April and May) witnessed negligible sales due to COVID-19 and business activities take time to normalise. We have reduced our EBIDTA estimates by about 10% for FY22. At CMP, the stock is trading at 10x FY22 EV/EBIDTA which is close to its long-term historical average of 11-12x, leaving limited scope of an upside from the current levels. Hence, we retain our Hold rating on the stock with a revised PT of Rs 60.

Key Risks

Prolonged weakness in the economic growth would keep the MHCV demand under pressure and is key risk to our call.

Valuation Rs cr

Particulars	FY18	FY19	FY20E	FY21E	FY22E
Netsales(Rscr)	26,356.4	29,055.0	17,467.5	15,232.5	20,657.0
Growth(%)	30.9	10.2	-39.9	-12.8	35.6
EBIDTA(Rscr)	2,963.5	3,135.7	1,173.7	760.7	1,587.4
OPM(%)	11.2	10.8	6.7	5.0	7.7
PAT(Rscr)	1,746.2	2,040.7	395.3	21.1	634.2
Growth(%)	*12.0*	*16.9*	*-80.6*	*-94.7*	-
FDEPS(Rs)	6.0	7.0	1.3	0.1	2.2
P/E(x)	8.7	7.5	38.6	722.1	24.1
P/BV(x)	2.1	1.8	2.1	2.3	2.4
EV/EBITDA(x)	5.0	4.5	14.0	21.1	10.0
RoCE(%)	20.3	21.7	4.1	0.0	7.4
RoE(%)	24.1	24.5	5.4	0.3	9.9

Source: Company, Sharekhan Research

Operating performance ahead of estimates; PAT impacted by impairment loss on equity investment: Q4 operating results of ALL were better than our as well as street expectations as the company posted better than expected realisations per vehicle and margins. Revenues declined 57% y-o-y to Rs 3,839 cr driven by 57% y-o-y drop in volumes. However, realisation per vehicle grew marginally 1% y-o-y as against expectations of 7% y-o-y drop. Better product mix in the MHCV segment (sales of higher tonnage trucks) led to better than expected realisations. Revenues were ahead of our estimates of Rs 3,516 cr. Operating margins declined 630 bps y-o-y to 4.8% but were ahead of our estimates of 4%. Raw material costs declined 160 bps y-o-y driven by soft commodity prices and discounts received from vendors. However, employee and other expenditure rose sharply (driven by negative operating leverage due to steep volume drop) leading to overall dip in the margins. EBIDTA at Rs 183 cr declined 81% y-o-y but was ahead of our estimates of Rs 139 cr. Depreciation grew 18% y-o-y to Rs 188 cr. Ashok Leyland realised tax credit of Rs 14.8 cr on account of MAT. Provision for impairment loss on equity investment (in subsidiary Optare) to the tune of Rs 66 cr impacted the PAT. Ashok Leyland reported loss of Rs 57 cr which was higher than our estimates of Rs 16 cr loss.

MHCV demand to be impacted as economy expected to contract in FY21; recovery to take time: COVID-19 led to the Indian Government announcing a complete lockdown for about a month (March 24,2020 to April 20, 2020). While the Government relaxed lockdown norms from April 2020 and allowed businesses to operate, the business activity has been impacted. Businesses would take time to reach normalcy. Leading rating agencies have sharply cut India's economic growth for FY2021. IMF expects the Indian economy to contract by 4.5% in FY2021. MHCV (forming about 75% of revenues) for ALL is directly linked to the economic growth prospects and demand is likely to remain under pressure in the near term. We expect MHCV volumes to drop in sharp double digits in FY21. Economic growth is expected to take time to revive and we expect MHCV demand to remain under pressure over the next three to four quarters.

Key conference call highlights

- **Demand outlook:** The management did not provide any volume outlook for FY21 given the uncertainty on account of COVID-19 pandemic.
- **MHCV segmental performance:** While the haulage demand remains weak, ALL stated the tipper demand is gradually improving with pick up in construction activities.
- **AVTR platform for BS6:** ALL launched modular platform named "AVTR" under the BS 6 emission norms. As per the management, customers can choose their configurations under AVTR and the vehicle would be built accordingly. ALL has bought down MHCV platforms from 3 earlier to only AVTR currently which would reduce the overall development cost. As per ALL, AVTR trucks would provide lowest Total cost of ownership for fleet operators.
- **Phoenix LCV launch:** Management stated it would launch the Phoenix light commercial vehicle over the next three months which would further strengthen their product portfolio in the LCV segment. ALL is targeting market share gains in the LCV segment with launch of Phoenix.
- **Cost control initiatives:** ALL stated that it realised savings worth Rs 560 cr in FY2020 and cost control measures would continue in FY2021.
- **Capex outlook:** Management stated that majority of the capex has been done in FY20 (launch of new platform and transition to BS6 emission norms). Thus, the company would incur only maintenance capex in FY21
- **Investments in subsidiaries:** ALL stated that investments in subsidiaries would continue depending upon their funding requirements.
- **MHCV market share:** ALL marginally lost market share in the MHCV segment in FY20. ALL share dropped to 31.8% in FY20 as against 33.3% in FY19.
- **Public transportation:** ALL stated that there could be hesitation on part of people to use public transport initially which could impact the demand for buses in near term.
- **Debt:** ALL current gross debt stands at Rs 5,400 cr while Net Debt stands at Rs 4,000 cr. ALL Debt: Equity stands at about 0.6x.

Results

Rs cr

Particulars	Q4FY20	Q4FY19	YoY (%)	Q3FY20	QoQ (%)
Net sales	3838.5	8845.9	-56.6	4015.7	-4.4
Operating profit	183.0	985.4	-81.4	225.2	-18.7
OPM (%)	4.8%	11.1%	(630) bps	5.6%	(80) bps
Depreciation	187.7	159.8	17.5	157.5	19.2
Interest	33.1	16.6	99.3	33.7	-1.7
Other Income	34.4	9.1	279.3	22.3	54.2
PBT	-3.4	818.2	-100.4	56.3	-106.0
Tax	-14.8	153.5	-109.6	26.4	-155.9
Adjusted PAT	11.4	664.7	-98.3	29.9	-61.9
Reported PAT	-57.3	653.0	-108.8	27.8	-306.6
Recurring EPS	0.0	2.3	-98.3	0.1	-61.9

Source: Company

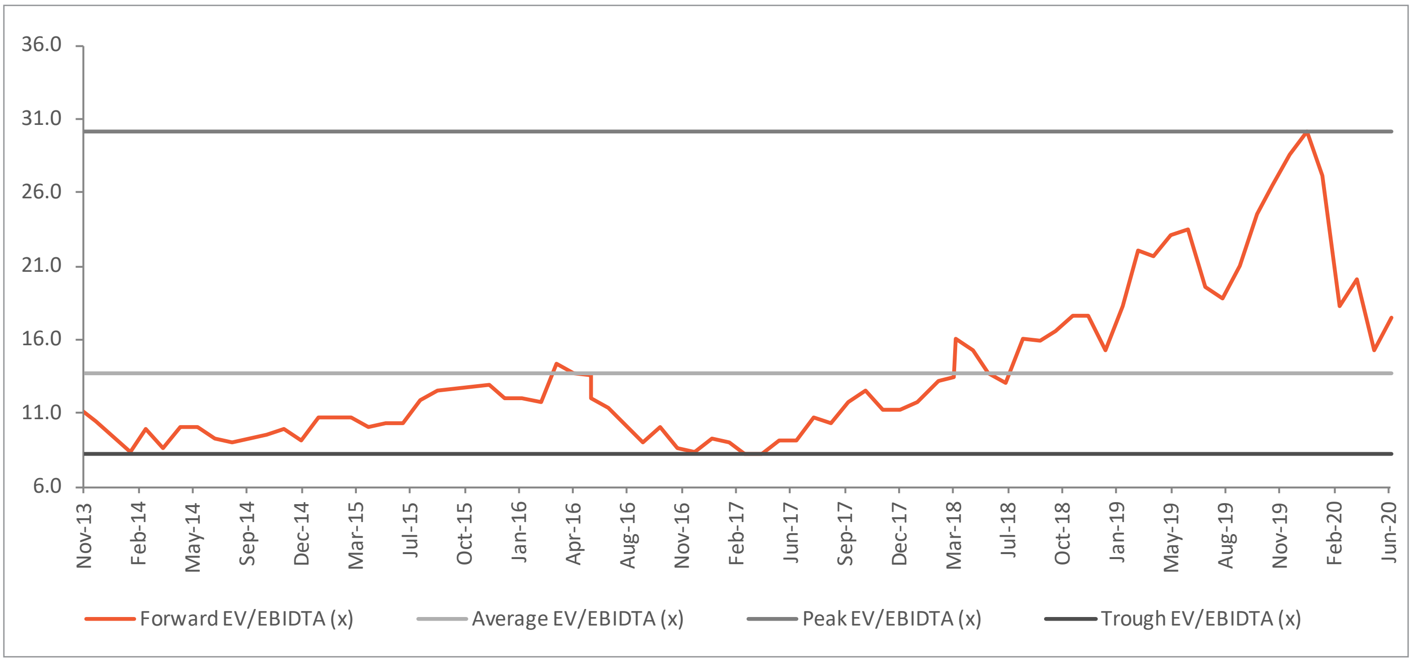
Outlook

Demand challenges to sustain in near term: MHCV demand is likely to remain under pressure in the near term driven by drop in economic growth on account of COVID-19. While the MHCV truck supply has improved (after relaxation of lockdown) and axle load norms, the demand continues to be under pressure which is impacting trucker profitability and thus new truck demand. We expect MHCV segment to report a drop over the next two to three quarters as economic growth would take time to reach normalcy.

Valuation

Cut FY22 estimates; retain Hold with revised PT of Rs 60: ALL volumes are expected to drop sharply in FY21 as first two months of FY21 (April and May) witnessed negligible sales due to COVID-19 and business activities take time to normalise. We have reduced our EBIDTA estimates by about 10% for FY22.At CMP, the stock is trading at 10x FY22 EV/EBIDTA which is close to its long-term historical average of 11-12x, leaving limited scope of upside from current levels. Hence, we retain Hold rating on the stock with a revised PT of Rs 60.

One-year forward EV/EBIDTA (x) band



Source: Sharekhan Research

About company

Ashok Leyland (ALL) is the flagship company of the Hinduja Group and is the second-largest domestic manufacturer of medium and heavy commercial vehicles (MHCVs). ALL derives 70% of volumes from MHCV segment, while light commercial vehicles (LCVs) form the balance 30%. ALL is the market leader for MHCV buses with a market share of 41%, while it is the second-largest player in MHCV trucks having a market share of 33%. Domestic revenue contributes 87% of the revenues while exports contribute the balance 13%.

Investment theme

MHCV industry is expected to remain in the declining trend over the next three to four quarters on back of weak economic growth due to COVID-19. While MHCV truck supply has improved (after relaxation of lockdown) and axle load norms, the demand continues to be under pressure which is impacting trucker profitability and thus new truck demand. Economic activity would take time to reach normalcy and we expect near term MHCV demand pressures to sustain. We expect growth to recover in FY22 which would revive truck demand. Hence, we retain Hold rating on the stock.

Key Risks

- ALL is a pure CV play, with MHCVs constituting ~70% of revenues. The MHCV industry is cyclical and exposes ALL to the volatility of the industry cycles.
- Trend of persistent higher discounts in the MHCV segment to defend market share would affect industry margins.

Additional Data

Key management personnel

Mr Dhiraj Hinduja	Chairman
Vipin Sondhi	Managing Director & CEO
Gopal Mahadevan	Chief Financial Officer
Nitin Seth	Chief Operating Officer

Source: Company Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Hinduja Automotive Ltd	34.73
2	HINDUJA BANK SWITZERLAND	4.94
3	JPMorgan Chase & Co	4.30
4	Reliance Capital Trustee Co Ltd	4.12
5	ICICI Prudential Life Insurance Co	1.72
6	State of Kuwait	1.70
7	Norges Bank	1.63
8	GOVERNMENT PENSION FUND - GLOBAL	1.47
9	BlackRock Inc	1.43
10	Vanguard Group Inc/The	1.38

Source: Bloomberg

Sharekhan

by BNP PARIBAS

Know more about our products and services

For Private Circulation only

Disclaimer: This document has been prepared by Sharekhan Ltd. (SHAREKHAN) and is intended for use only by the person or entity to which it is addressed to. This Document may contain confidential and/or privileged material and is not for any type of circulation and any review, retransmission, or any other use is strictly prohibited. This Document is subject to changes without prior notice. This document does not constitute an offer to sell or solicitation for the purchase or sale of any financial instrument or as an official confirmation of any transaction. Though disseminated to all customers who are due to receive the same, not all customers may receive this report at the same time. SHAREKHAN will not treat recipients as customers by virtue of their receiving this report.

The information contained herein is obtained from publicly available data or other sources believed to be reliable and SHAREKHAN has not independently verified the accuracy and completeness of the said data and hence it should not be relied upon as such. While we would endeavour to update the information herein on reasonable basis, SHAREKHAN, its subsidiaries and associated companies, their directors and employees ("SHAREKHAN and affiliates") are under no obligation to update or keep the information current. Also, there may be regulatory, compliance, or other reasons that may prevent SHAREKHAN and affiliates from doing so. This document is prepared for assistance only and is not intended to be and must not alone be taken as the basis for an investment decision. Recipients of this report should also be aware that past performance is not necessarily a guide to future performance and value of investments can go down as well. The user assumes the entire risk of any use made of this information. Each recipient of this document should make such investigations as it deems necessary to arrive at an independent evaluation of an investment in the securities of companies referred to in this document (including the merits and risks involved), and should consult its own advisors to determine the merits and risks of such an investment. The investment discussed or views expressed may not be suitable for all investors. We do not undertake to advise you as to any change of our views. Affiliates of Sharekhan may have issued other reports that are inconsistent with and reach different conclusions from the information presented in this report.

This report is not directed or intended for distribution to, or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, where such distribution, publication, availability or use would be contrary to law, regulation or which would subject SHAREKHAN and affiliates to any registration or licensing requirement within such jurisdiction. The securities described herein may or may not be eligible for sale in all jurisdictions or to certain category of investors. Persons in whose possession this document may come are required to inform themselves of and to observe such restriction.

The analyst certifies that the analyst has not dealt or traded directly or indirectly in securities of the company and that all of the views expressed in this document accurately reflect his or her personal views about the subject company or companies and its or their securities and do not necessarily reflect those of SHAREKHAN. The analyst further certifies that neither he or its associates or his relatives has any direct or indirect financial interest nor have actual or beneficial ownership of 1% or more in the securities of the company at the end of the month immediately preceding the date of publication of the research report nor have any material conflict of interest nor has served as officer, director or employee or engaged in market making activity of the company. Further, the analyst has also not been a part of the team which has managed or co-managed the public offerings of the company and no part of the analyst's compensation was, is or will be, directly or indirectly related to specific recommendations or views expressed in this document. Sharekhan Limited or its associates or analysts have not received any compensation for investment banking, merchant banking, brokerage services or any compensation or other benefits from the subject company or from third party in the past twelve months in connection with the research report.

Either SHAREKHAN or its affiliates or its directors or employees / representatives / clients or their relatives may have position(s), make market, act as principal or engage in transactions of purchase or sell of securities, from time to time or may be materially interested in any of the securities or related securities referred to in this report and they may have used the information set forth herein before publication. SHAREKHAN may from time to time solicit from, or perform investment banking, or other services for, any company mentioned herein. Without limiting any of the foregoing, in no event shall SHAREKHAN, any of its affiliates or any third party involved in, or related to, computing or compiling the information have any liability for any damages of any kind.

Compliance Officer: Mr. Joby John Meledan; Tel: 022-61150000; email id: compliance@sharekhan.com;

For any queries or grievances kindly email igc@sharekhan.com or contact: myaccount@sharekhan.com

Registered Office: Sharekhan Limited, 10th Floor, Beta Building, Lodha iThink Techno Campus, Off. JVLR, Opp. Kanjurmarg Railway Station, Kanjurmarg (East), Mumbai – 400042, Maharashtra. Tel: 022 - 61150000. Sharekhan Ltd.: SEBI Regn. Nos.: BSE / NSE / MSEI (CASH / F&O / CD) / MCX - Commodity: INZ000171337; DP: NSDL/CDSL-IN-DP-365-2018; PMS: INP000005786; Mutual Fund: ARN 20669; Research Analyst: INH000006183;