Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Ashok Leyland Limited

Beneficiary of recovery in the CV industry

Automobiles	Sharekhan code: ASHOKLEY	Result Update

3R MATRIX	+	=	-
Right Sector (RS)	✓		
Right Quality (RQ)	✓		
Right Valuation (RV)	✓		

\+ Positive = Neutral - Negative

What has changed in 3R MATRIX

	Old		New
RS		⇔	
RQ		⇔	
RV		⇔	

Reco/View	Change
Reco: **Buy**	⇔
CMP: **Rs. 128**	
Price Target: **Rs. 151**	↑

↑ Upgrade ⇔ Maintain ↓ Downgrade

Company details

Market cap:	Rs. 37,575 cr
52-week high/low:	Rs. 139 / 34
NSE volume: (No of shares)	438.6 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Free float: (No of shares)	142.37 cr

Shareholding (%)

Promoters	51.1
FII	16.2
DII	17.6
Others	15.1

Price chart

Price performance

(%)	1m	3m	6m	12m
Absolute	5.5	43.8	149.5	54.6
Relative to Sensex	1.4	25.5	114.5	28.8

Sharekhan Research, Bloomberg

Summary

- We reiterate our Buy rating on Ashok Leyland Limited (ALL) with a revised PT of Rs 151, owing to faster than expected recovery in macro-economic activities, leading to benefits in the CV industry
- ALL's Q3FY21 results were below expectations, mainly due to lower than expected recovery in EBITDA margins.
- We expect ALL's profitability to improve significantly, with its EBITDA growing at 157% CAGR for FY2021-23E.
- Despite the run up in the stock, it is still available below its historical average multiples. The stock is trading at P/E of 18.3x and EV/EBITDA of 10.2x its FY2023E estimates. We retain our Buy rating on the stock.

Ashok Leyland Limited's (ALL) Q3FY21 results were below expectations, mainly due to lower-than-expected recovery in EBITDA margins. Net revenue grew by 19.9% y-o-y to Rs 4,814 crore in Q3FY21, led by 7.1% growth in volumes and 11.9% growth in average realisations. The company reported EBITDA margin contraction of 33 bps y-o-y at 5.3% for the Q3FY21, which was lower by 233 bps from our expectations. The margin contraction was due to the rise in the raw material cost per vehicle by 13.3% y-o-y. The raw material per vehicle jumped 3.2% on q-o-q in this quarter. As a result, EBITDA grew by 12.7% y-o-y to Rs 254 crore in Q3FY21. The adjusted PAT declined by 4% y-o-y to Rs 27 crore in Q3FY21, due to higher depreciation and interest cost. We have revised ALL's volume estimates upwards on expectation that the CV industry is ready for an upturn. We expect ALL's EBIDTA margin will improve aided by benefits arising from operating leverage and cost-cutting initiatives taken up by the company under 'Project Reset'. As per the management, under the Project Reset, the company will focus on pricing, network profitability, supply chain de-bottlenecking, and other manufacturing overheads. Operating leverage (due to volume growth) and cost-control initiatives would lead to steep improvement in margins. OPM is expected to reach double-digit levels in FY2022E (closer to FY2019 levels). ALL is the second largest medium and heavy commercial vehicle (MHCV) manufacturer with 32% market share. In MHCV buses, ALL is the market leader commanding market share of 45%, while its market share stands at 29% in MHCV trucks. ALL is focusing on reducing its dependence on the cyclical truck business, which constitutes about 65% of revenue currently. ALL is improving its light commercial vehicles (LCV) business and is targeting market share gains with the launch of new products. The company has also identified CV exports and defence as key focus areas. ALL is planning to increase its distribution network in Africa and other Southeast Asian countries to boost exports. With 'Atmanirbhar Bharat' push in the defence sector, the government is targeting increased sourcing from domestic private players, which would benefit players such as ALL. We expect ALL's profitability to improve significantly, with its EBITDA growing at 157% CAGR for FY2021-23E. We thus remain positive on ALL's growth prospects and retain Buy rating on the stock.

Our Call

Valuation - Maintain Buy with a revised PT of Rs. 151: We have revised ALL's volume estimates upwards on expectation that the CV industry is ready for an upturn. We expect ALL's EBIDTA margin will improve aided by benefits arising from operating leverage and cost-cutting initiatives taken up by the company under 'Project Reset'. The sudden increase in economic activities related to infrastructure, mining and e-commerce has led to strong sequential growth in vehicles. In the M&HCV space, the company has increased its market share to 28.1% in Q3FY21 from 24.8% in Q3FY20. We remain positive on ALL and expects it to be beneficiary of upturn in CV cycle. Despite the run up in the stock, the stock is available below its historical average multiples. The stock is trading at P/E of 18.3x and EV/EBITDA of 10.2x its FY2023E estimates. We retain our Buy rating on the stock.

Key risk

The second wave of COVID-19 pandemic can disrupt economic sentiments and affect prospects of the CV industry's recovery. Pricing pressures to defend domestic market share would affect margins. Also, if the commodity prices continue to rise going forward, can affect the company's profitability.

Valuations Rs cr

Particulars	FY19	FY20	FY21E	FY22E	FY23E
Revenues	29,055	17,467	13,729	22,654	29,246
Growth (%)	10.2	(39.9)	(21.4)	65.0	29.1
EBIDTA	3,136	1,174	545	2,041	3,593
OPM (%)	10.8	6.7	4.0	9.0	12.3
Net Profit	2,041	395	(241)	864	2,053
Growth (%)	16.9	(80.6)	(161.0)	(458.3)	137.7
EPS	6.8	0.8	(0.7)	2.9	7.0
P/E	18.9	156.9	(189.4)	43.5	18.3
P/BV	4.5	5.2	5.4	5.1	4.3
EV/EBIDTA	11.6	33.3	71.4	18.7	10.2
ROE (%)	24.5	5.4	-3.5	11.6	23.5
ROCE (%)	22.6	4.0	(1.6)	10.4	21.7

Source: Company; Sharekhan estimates

ALL's operational performance lags expectations in Q3FY21: Ashok Leyland Limited's (ALL) Q3FY21 results were below expectations, mainly due to lower-than-expected recovery in EBITDA margins. Net revenue grew by 19.9% y-o-y to Rs 4,814 crore in Q3FY21, led by 7.1% growth in volumes and 11.9% growth in average realisations. The average realisation improved on back of price hikes taken by the company owing to BS-VI transition, partially offset by inferior product mix due to higher share of LCV business. The company reported EBITDA margin contraction of 33 bps y-o-y at 5.3% for the Q3FY21, which was lower by 233 bps from our expectations. The margin contraction was due to rise in raw material cost per vehicle by 13.3% y-o-y. The raw material per vehicle jumped 3.2% on q-o-q in this quarter. As a result, EBITDA grew by 12.7% y-o-y to Rs 254 crore in Q3FY21. The adjusted PAT declined by 4% y-o-y to Rs 27 crore in Q3FY21, due to higher depreciation and interest cost. During the quarter Q3FY21, the company had an exceptional item of Rs 46 crore, related to obligation related to discontinued products of LCV division and VRS expenses.

Positive on CV recovery; Revise upwards ALL's volumes and earnings estimates to capture demand: We have revised ALL's volume estimates upwards on expectation that the CV industry is ready for an upturn. We expect ALL's EBIDTA margin will improve aided by benefits arising from operating leverage and cost-cutting initiatives taken up by the company under 'Project Reset'. As per the management, under the Project Reset, the company will focus on pricing, network profitability, supply chain de-bottlenecking, and other manufacturing overheads. Operating leverage (due to volume growth) and cost-control initiatives would lead to steep improvement in margins. OPM is expected to reach double-digit levels in FY2022E (closer to FY2019 levels). Moreover, ALL is focusing on enhancing CV exports (by introducing new products and network expansion) and increasing revenue from aftermarket (driven by increased digitisation and network enhancement) and defence segment (through the government's Atmanirbhar Bharat push). The government has announced scrappage scheme for older vehicles. The details are awaited. An incentive-based scrappage scheme (providing incentives on new truck purchase in lieu of scrapping old trucks) would boost demand and would be positive, however it depends upon the incentive schemes.

Management optimism: The management remains optimistic about the growth prospects for commercial vehicles. The sudden increase in economic activities related to infrastructure, mining and e-commerce has led to strong sequential growth in vehicles. In the M&HCV space, the company has increased its market share to 28.1% in Q3FY21 from 24.8% in Q3FY20. ALL's Bada Dost was launched in September'20 is receiving favourable response from the markets. Further, the Government's thrust on infrastructure, growth led investment schemes and scrappage policy is expected to keep the demand scenario favourable.

Concerned with the ECU shortage and rise in commodity prices: The company is concerned with a shortage of semi-conductors, which is now a global phenomenon, likely to affect vehicle production, if the supply shortage persists for long period. However, ALL's production in unlikely to get impacted in the current situation. Also, the unprecedented rise in commodity prices have impacted the margins. The company took a price hike in January'21 and expects to take another price hike.

Investments and subsidiaries: ALL continued to invest in its subsidiaries SWITCH and Hinduja Finance Limited. The company sees SWITCH as a global arm for Ashok Leyland in the electrified vehicle space, having a huge interest in Indian markets. The Hinduja Finance company is performing well with the collection efficiency more than 90%. The moratorium accounts are doing well.

Strong position in medium and heavy commercial vehicles; Focusing to improve non- cyclical truck business: ALL is the second largest medium and heavy commercial vehicle (MHCV) manufacturer with 32% market share. In MHCV buses, ALL is the market leader commanding market share of 45%, while its market share stands at 29% in MHCV trucks. ALL is focusing on reducing its dependence on the cyclical truck business, which constitutes about 65% of revenue currently. ALL is improving its light commercial vehicles (LCV) business and is targeting market share gains with the launch of new products. The company has also identified CV exports and defence as key focus areas. ALL is planning to increase its distribution network in Africa and other Southeast Asian countries to boost exports. With the 'Atmanirbhar Bharat' push in the defence sector, the government is targeting increased sourcing from domestic private players, which would benefit players such as ALL.

Positive outlook going forward: The company expects industry demand to improve as the economy opens up and business activities gain momentum. ALL expects the CV industry to report growth over the next few quarters. The company is witnessing divergent trends for various segments in the CV industry. Tippers, multi-axle vehicles, and light and intermediate commercial vehicles are performing better, while the bus segment is yet to pick up. To ensure social distancing (people are avoiding public transport) and with schools not yet reopening, the bus segment's demand is lagging behind. ALL is expected to benefit from new launches in intermediate commercial vehicles (ICV). The Bada Dost in LCV has been well received by the market. We expect Bada Dost to contribute to ALL's strong growth in FY2022E and FY2023E.

Results Rs cr

Particulars	Q3FY21	Q3FY20	YoY%	Q2FY21	QoQ%
Net sales	4,814	4,016	19.9	2,837	69.7
Operating profit	253.8	225.2	12.7	80.4	215.5
OPM (%)	5.3	5.6	(33 bps)	2.8	244 bps
Depreciation	194.4	157.5	23.5	171.2	13.6
Interest	65.6	33.7	94.9	87.2	(24.8)
Other Income	34.1	22.3	52.5	21.9	55.7
PBT	27.8	56.3	-50.7	(156.1)	NA
Tax	1.1	26.4	-95.7	(11.1)	NA
Reported PAT	(19.4)	29.9	NA	(145.0)	NA
Adjusted PAT	26.7	27.8	-4.0	(146.7)	NA
Recurring EPS	0.1	0.1	-4.0	(0.5)	NA

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector View – CV sales improving; Expect strong recovery in FY2022

After eight consecutive quarters of de-growth, the M&HCV has registered a growth of 16% y-o-y in Q3FY21. While the industry bus volumes continued to lag, these are expected to recover with the opening of restrictions. The rolling of vaccines throughout the country will also ease fear of COVID. We expect strong double-digit growth for the CV segment from FY2022. The expected normalisation of economic activities is likely to drive demand.

■ Company Outlook – Beneficiary of recovery in the CV industry

We believe the CV industry is poised for an upturn in the market due to faster-than-expected recovery in economic activities. There has been a continuous uptick in economic activities after the government announced unlock measures. There has been substantial improvement in infrastructure, road construction, and mining activities. Channel check suggests fleet operators are running over 60% capacity and expect it to improve sequentially. New demand for trucks typically happens when fleet operators start operating above 80% utilization. Moreover, ALL will benefit from replacement demand, which is likely to arise due to lower ownership costs for BS-VI vehicles as compared to BS-IV vehicles. Bus demand is also expected to rise from Q4FY2021, as the public resumes to normal life.

■ Valuation – Maintain Buy with a revised PT of Rs. 151

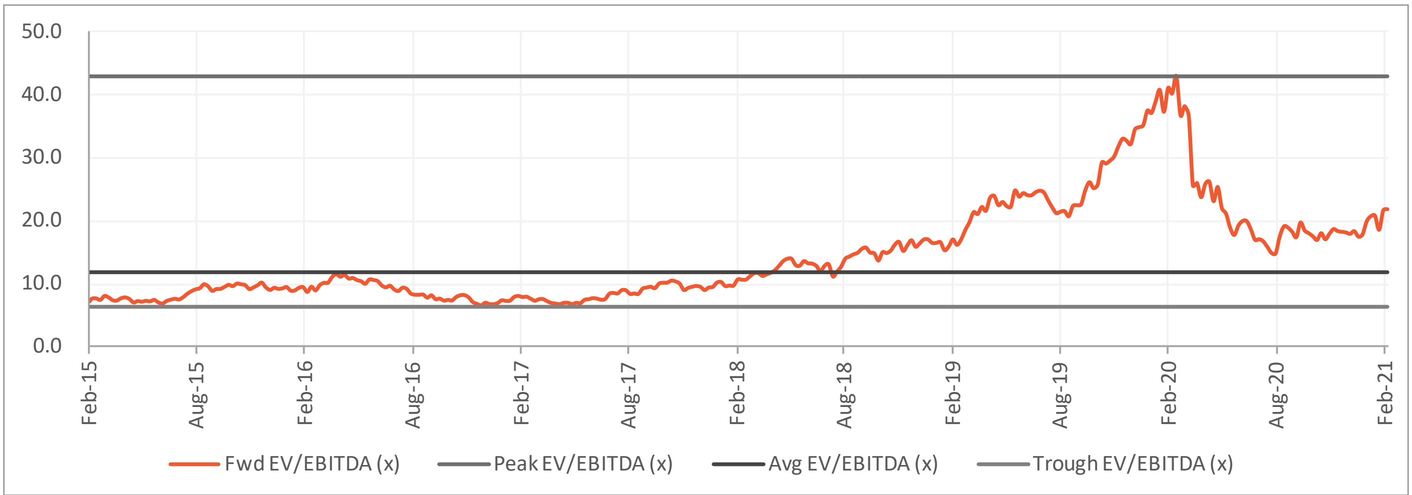
We have revised ALL's volume estimates upwards on expectation that the CV industry is ready for an upturn. We expect ALL's EBIDTA margin will improve aided by benefits arising from operating leverage and cost-cutting initiatives taken up by the company under 'Project Reset'. The sudden increase in economic activities related to infrastructure, mining and e-commerce has led to a strong sequential growth in vehicles. In the M&HCV space, the company has increased its market share to 28.1% in Q3FY21 from 24.8% in Q3FY20. We remain positive on ALL and expects it to be beneficiary of upturn in CV cycle. Despite the run up in the stock, the stock is available below its historical average multiples. The stock is trading at P/E of 18.3x and EV/EBITDA of 10.2x its FY2023E estimates. We retain our Buy rating on the stock.

Price Target calculation

Particulars	
FY23E EBITDA (Rs cr)	3,593
Target EV/EBITDA Multiple (x)	12
Equity Value (Rs cr) - Core business	41,566
Equity Value (Rs/share) - Core business	142
HFL's Value	9
Fair Value of ALL Entity	151
Upside (%)	**18%**

Source: Company; Sharekhan Research

One-year forward EV/EBIDTA (x) band



Source: Sharekhan Research

About company

ALL is the flagship company of Hinduja Group and is the second-largest domestic manufacturer of MHCVs. ALL derives 70% of its volumes from the MHCV segment, while 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% to the revenue, while exports contribute the balance 13%.

Investment theme

We believe the CV industry is poised for an upturn in the market due to faster-than-expected recovery in economic activities. There has been a continuous uptick in economic activities after the government announced unlock measures. ALL is the second largest MHCV manufacturer with 32% market share. In MHCV buses, ALL is the market leader commanding market share of 45%, while its market share stands at 29% in MHCV trucks. ALL is focusing on reducing its dependence on the cyclical truck business, which constitutes about 65% of revenue currently. ALL is improving its LCV business and is targeting market share gains with the launch of new products. We are positive on ALL due to faster-than-expected recovery in economic activities, especially in infrastructure development, road construction, and mining, which would likely spur demand for new trucks. Demand for CVs is expected to arise from replacement as well as new demand. Moreover, ALL is focusing on enhancing CV exports (by introducing new products and network expansion) and increasing revenue from replacement (driven by increased digitisation and network enhancement) and defence segment (through the government's Atmanirbhar Bharat push). The government is finalising a scrappage scheme for the automotive sector. An incentive-based scrappage scheme (providing incentives on new truck purchase in lieu of scrapping old trucks) would significantly boost demand and would be positive for the company. Hence, we retain our Buy rating on the stock.

Key Risks

- The second wave of COVID-19 pandemic can disrupt economic sentiments and affect prospects of the CV industry's recovery.
- Pricing pressures to defend domestic market share would affect margins. Also, if the commodity prices continue to rise going forward, can affect the company's profitability.

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	JP Morgan Chase & Co	4.4
4	Kuwait Investment Authority	1.72
5	Government Pension Fund Global	1.63
6	Norges Bank	1.63
7	ICICI Prudential Life Insurance Company	1.5
8	Vangaurd Group Inc	1.47
9	Blackrock Inc	1.43
10	Life Insurance Corp of India	1.36

Source: Bloomberg

Understanding the Sharekhan 3R Matrix

Right Sector	
Positive	Strong industry fundamentals (favorable demand-supply scenario, consistent industry growth), increasing investments, higher entry barrier, and favorable government policies
Neutral	Stagnancy in the industry growth due to macro factors and lower incremental investments by Government/private companies
Negative	Unable to recover from low in the stable economic environment, adverse government policies affecting the business fundamentals and global challenges (currency headwinds and unfavorable policies implemented by global industrial institutions) and any significant increase in commodity prices affecting profitability.
Right Quality	
Positive	Sector leader, Strong management bandwidth, Strong financial track-record, Healthy Balance sheet/cash flows, differentiated product/service portfolio and Good corporate governance.
Neutral	Macro slowdown affecting near term growth profile, Untoward events such as natural calamities resulting in near term uncertainty, Company specific events such as factory shutdown, lack of positive triggers/events in near term, raw material price movement turning unfavourable
Negative	Weakening growth trend led by led by external/internal factors, reshuffling of key management personal, questionable corporate governance, high commodity prices/weak realisation environment resulting in margin pressure and detoriating balance sheet
Right Valuation	
Positive	Strong earnings growth expectation and improving return ratios but valuations are trading at discount to industry leaders/historical average multiples, Expansion in valuation multiple due to expected outperformance amongst its peers and Industry up-cycle with conducive business environment.
Neutral	Trading at par to historical valuations and having limited scope of expansion in valuation multiples.
Negative	Trading at premium valuations but earnings outlook are weak; Emergence of roadblocks such as corporate governance issue, adverse government policies and bleak global macro environment etc warranting for lower than historical valuation multiple.

Source: Sharekhan Research

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