Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Ashok Leyland Limited

Q4 outruns hopes; riding on recovery hopes

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. 124**	
Price Target: **Rs. 151**	↔

↑ Upgrade ↔ Maintain ↓ Downgrade

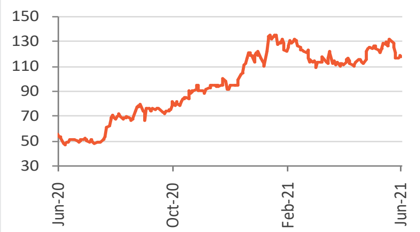
Company details

Market cap:	Rs. 36,401 cr
52-week high/low:	Rs. 139/ 47
NSE volume: (No of shares)	258.6 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Free float: (No of shares)	142.37 cr

Shareholding (%)

Promoters	51.1
FII	17.9
DII	16.7
Others	14.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-6.6	1.6	24.4	110.3
Relative to Sensex	-10.7	-4.1	10.4	61.6

Sharekhan Research, Bloomberg

Summary

- Q4FY21 results beat street expectations, led by better average realization and sharp EBITDA margin expansion.
- We expect ALL's profitability to improve significantly, with its EBITDA growing at 159% CAGR for FY2021-23E, aided by robust 38.2% revenue CAGR and sharp margin expansion.
- The stock trades below average historical multiples at P/E of 17.7x and EV/EBITDA of 9.9x its FY2023E estimates.
- We retain a Buy on Ashok Leyland with an unchanged PT of Rs 151, given the expected recovery in the CV industry post normalisation of economic activities.

Ashok Leyland Limited (ALL) reported strong operational performance in Q4FY21 results, beating street expectations. Standalone net revenues grew by 45.4% q-o-q to Rs7,000 crore, aided by a growth of 31.9% in volumes and 10.3% in average realisation. The improvement in average realisation was on the account of price hikes and product mix. EBITDA margin improved better than expectation to 7.6%, an improvement of 230 bps q-o-q and 280 bps y-o-y, aided by operating leverage benefits and cost reductions. The rising raw material costs impacted gross margins at 23.1% in Q4FY21 – a 250 bps decline q-o-q and 580 bps decline in y-o-y. The average raw material cost per vehicle rose 13.9% q-o-q in Q4FY21, as against 10.3% improvement in average realisation. Improvement in EBITDA margin helped EBITDA to grow by robust 110.5% q-o-q to Rs254 cr. Adjusted PAT improved more than 6x q-o-q to Rs204 crore in Q4FY21. The company had a net loss of Rs57 crore in Q4FY20. Q4FY21 consolidated revenue was at Rs. 8,142 crore, a 60% y-o-y increase from Rs. 5,088 crore in Q4FY20. Consolidated PAT for Q4FY21 stood at Rs. 377 crore which is 5.5x higher than Q4FY20 PAT of Rs. 58 crore. The management is positive for CV growth in the medium term, as India's GDP is expected to grow by 9.5% in FY22. The company sees good opportunities to continue to grow the exports, defence, power solutions, LCV and parts business even as it expands the reach and products of the core MHCV business. The increase in economic activities related to infrastructure, mining and e-commerce would fuel demand for LCVs and M&HCVs. ALL is well placed in the industry to benefit from the expected recovery in the CV industry, aided by its focus on increasing market share through increased penetration across all region and new product launches. 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 159% CAGR for FY2021-23E. Also, the company's earnings- are expected to turnaround in FY22E with a net profit of Rs859.5 crore as against a net loss of Rs 301.6 crore in FY21. We thus remain positive on ALL's growth prospects and retain Buy rating on the stock.

Key positives

- The management gave a positive outlook for CV industry and continues to growth opportunities for exports, defence, power solutions, LCV and parts business even as it expands the reach and products of the core MHCV business.
- EBITDA margin expansion of 230 bps q-o-q and 280 bps y-o-y to 7.6% in Q4FY21 as against expectations of 5.9%.

Key negatives

- The gross margins declined 250 bps q-o-q at 23.1%, due to a 13.9% rise in average raw material cost per vehicle against 10.3% improvement in average realisation.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 151: We have maintained our volume and earnings estimates, as we expect the volumes to recover, despite the business getting adversely impacted in May-June'21 due to second wave of COVID-19. We expect ALL's EBIDTA margin to improve aided by benefits arising from operating leverage and cost-cutting initiatives taken up by the company. Further, the company is well poised to benefit from the growth in infrastructure, mining and e-commerce. In the M&HCV space, the company has increased its market share to 28.9% in Q4FY21 from 28.1% in Q3FY21. We remain positive on ALL and expects it to be beneficiary of upturn in CV cycle. We expect the company's earnings to turnaround in FY22E with a net profit of Rs859.5 crore as against a net loss of Rs 301.6 crore in FY21, aided by 48% growth in revenues and sharp margin expansion. The stock is trading below its average historical multiple at P/E of 17.7x and EV/EBITDA of 9.9x its FY2023E estimates. We retain our Buy rating on the stock with an unchanged PT of Rs151.

Key Risks

Prolonged 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, it can affect the company's profitability.

Valuation (Standalone) Rs cr

Particulars	FY20	FY21E	FY22E	FY23E
Revenues	17,467	15,301	22,654	29,246
Growth (%)	(39.9)	(12.4)	48.0	29.1
EBIDTA	1,174	535	2,041	3,593
OPM (%)	6.7	3.5	9.0	12.3
Net Profit	395	(302)	859	2,052
Growth (%)	(80.6)	NA	NA	138.7
EPS	0.8	(1.0)	2.9	7.0
P/E	152.0	NA	42.4	17.7
P/BV	5.0	5.3	4.9	4.2
EV/EBIDTA	32.3	70.5	18.1	9.9
ROE (%)	5.4	NA	11.7	23.7
ROCE (%)	4.0	NA	10.4	21.8

Source: Company; Sharekhan estimates

ALL's operational performance beats expectations in Q4FY21: Ashok Leyland Limited (ALL) reported strong operational performance in Q4FY21 results, beating street expectations. Standalone net revenues grew by 45.4% q-o-q to Rs7,000 crore, aided by 31.9% growth in volumes and 10.3% in average realisation. The improvement in average realisation was on the account of price hikes and product mix. The volumes of M&HCV in Q4FY21 improved by 58.4% q-o-q to 26,277 units, while LCV volumes grew by 5.7% to 17,783 units. EBITDA margin improved better than expectation to 7.6%, an improvement of 230 bps q-o-q and 280 bps y-o-y. The improvement in margins were aided by operating leverage benefits and cost reductions. The rising raw material costs impacted gross margins at 23.1% in Q4FY21 – a 250 bps decline q-o-q and 580 bps decline in y-o-y. The average raw material cost per vehicle rose 13.9% q-o-q in Q4FY21, as against an 10.3% improvement in average realisation. Improvement in EBITDA margin helped EBITDA to grow by robust 110.5% q-o-q to Rs254 cr. Adjusted PAT improved more than 6x q-o-q to Rs204 crore in Q4FY21. The company had a net loss of Rs57 crore in Q4FY20. Q4FY21 consolidated revenue was at Rs. 8,142 crore, a 60% y-o-y increase from Rs. 5,088 crore in Q4FY20. Consolidated PAT for Q4FY21 stood at Rs. 377 crore which is 5.5x higher than Q4FY20 PAT of Rs. 58 crore. The board has recommended a dividend of Rs. 0.60 per equity share or 60%.

Key Highlights of conference call

Improving market share: During FY21, the CV industry faced multiple challenges such as COVID pandemic, a continuous rise in raw material prices, vehicle price hikes due to BS-VI transition despite pressure on demand, subdued passenger vehicle demand impacted by closure of schools, offices and lockdowns. Despite these challenges ALL gained market share across its segments. ALL's MHCV truck market share for Q4 FY21 has improved to 28.9% vis-a-vis 27.6% in Q4 FY20. On a q-o-q basis, the market share improved 80bps from 28.1% in Q3FY21. This performance was backed by the successful AVTR range - India's first modular truck platform which was launched in June '20.

Management outlook: The management is positive for growth in the medium term, as India's GDP is expected to grow by 9.5% in FY22. The company sees good opportunities to continue to grow the exports, defence, power solutions, LCV and parts business even as it expands the reach and products of the core MHCV business. The increase in economic activities related to infrastructure, mining and e-commerce would fuel demand for LCVs and M&HCVs. Despite being positive on the outlook, the management highlight the risk of COVID situation in the country. The management expects demand for passenger segments to improve after the opening of schools, offices and normalcy of other activities. The vaccination drive would further help in advancing demand for passenger vehicles. Also, the normal of hygiene and social distancing would lead to less passenger in a bus, which would add to bus demand in the medium term.

Margin outlook: 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 any serious impact. Also, the unprecedented rise in commodity prices have impacted the margins. The company took a various price hikes during FY21 to mitigate the impact. The company continues to focus on cost reductions, which has helped in sharp improvement in EBITA margins during Q4FY21. The company expects to benefit from operating leverage, as the management to increase volumes, aided by increase in penetration across the country and new product launches. Operating leverage (due to volume growth) and cost-control initiatives would lead to steep improvement in margins.

Focus on digitisation and new launches: ALL's focus on digitisation remains key focus for driving demand for CV business. The company's focus on its digital marketplace platform has helped it to tap market shares from unorganised aftersales and services markets. The digit platforms help in monitoring the fleet utilisation and productivity and also alarm customers of any critical issues in the fleet. The company's new launches such as Dost, Bada Dost and ATVR have received positive feedback from customers. The company to grow its businesses from new launches. The phoenix platform on which Dost and Bada Dost were launched, is expected to receive more launches over the next few years.

Export strategy: ALL's remain focused on exports, which currently contributes to 8-10% in terms of volumes. The company's key focus markets are Africa and MENA regions. The company has on boarded around 6-7 dealers, which has previous experience in automobile business and are local. In terms of the organisation structure, every markets have separate CEO and manager for focussed approach. The strategy would be to create market and brand recall in the cities for its LCV products and increase penetration, then would subsequently launch ICVs and M&HCVs. 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.

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 company expects to invests around Rs 100-150 crore in subsidiaries in FY22. The company infuse further investments, depending upon the business demand and requirement.

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. 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 (Standalone) — **Rs cr**

Particulars	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)
Net sales	7,000	3,838	82.4	4,814	45.4
Operating profit	534	183	192.0	254	110.5
OPM (%)	7.6	4.8	280 bps	5.3	230 bps
Depreciation	218	188	16.4	194	12.4
Interest	77	33	132.8	66	17.4
Other Income	38	34	10.2	34	11.4
PBT	277	(3)	NA	28	895.6
Tax	73	(15)	NA	1	6339.8
Reported PAT	241	11	2013.7	(19)	NA
Adjusted PAT	204	(57)	NA	27	664.8
Recurring EPS	0.7	-0.2	NA	0.1	664.8

Source: Company; Sharekhan Research

Volume Analysis — **(Rs per Vehicle)**

Particulars	Q4FY21	Q4FY20	YoY (%)	Q3FY21	QoQ (%)
Volumes (units)	44,060	25,504	72.8	33410	31.9
Realisation	15,88,854	15,05,042	5.6	14,40,739	10.3
RM/vehicle	12,21,832	10,70,013	14.2	10,72,257	13.9
Gross Profit/Vehicle	3,67,022	4,35,030	-15.6	3,68,482	-0.4
EBITDA/Vehicle	1,21,235	71,734	69.0	75,962	59.6
PAT/vehicle	46,260	-22,475	NA	7,977	479.9

Source: Company; Sharekhan Research

Outlook and Valuation

■ Sector view - Expect recovery in CV sales in FY2022, as the economy normalises

We see a strong underlying demand commercial vehicle domestically. Lockdowns and restrictions posed by State Governments due to sudden spike in COVID cases in wave-2 has hit footfalls and retail sales. We believe this to be a temporary issue and expect the situation to normalise from Q2FY22 onwards. We expect the strongest recovery in the CV segment in FY2022 and FY2023, driven by an improvement in economic activities, low interest rate regime, and an improvement in financing availability. We expect a strong improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure and mining activities post normalization of COVID.

■ Company outlook - Growth strategies in place to drive growth in medium term

ALL is likely to be key beneficiary from the expected recovery in domestic CV industry, as the lockdowns are lifted in the country and economy normalises. 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. 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. The demand for passenger segments to improve after the opening of schools, offices and normalcy of other activities. The vaccination drive would further help in advancing demand for passenger vehicles. Also, the normal of hygiene and social distancing would lead to less passenger in a bus, which would add to bus demand in the long term. The company is well to benefits from growth in exports, defence, power solutions, LCV and parts business even as it expands the reach and products of the core MHCV business.

■ Valuation - Maintain Buy with an unchanged PT of Rs. 151

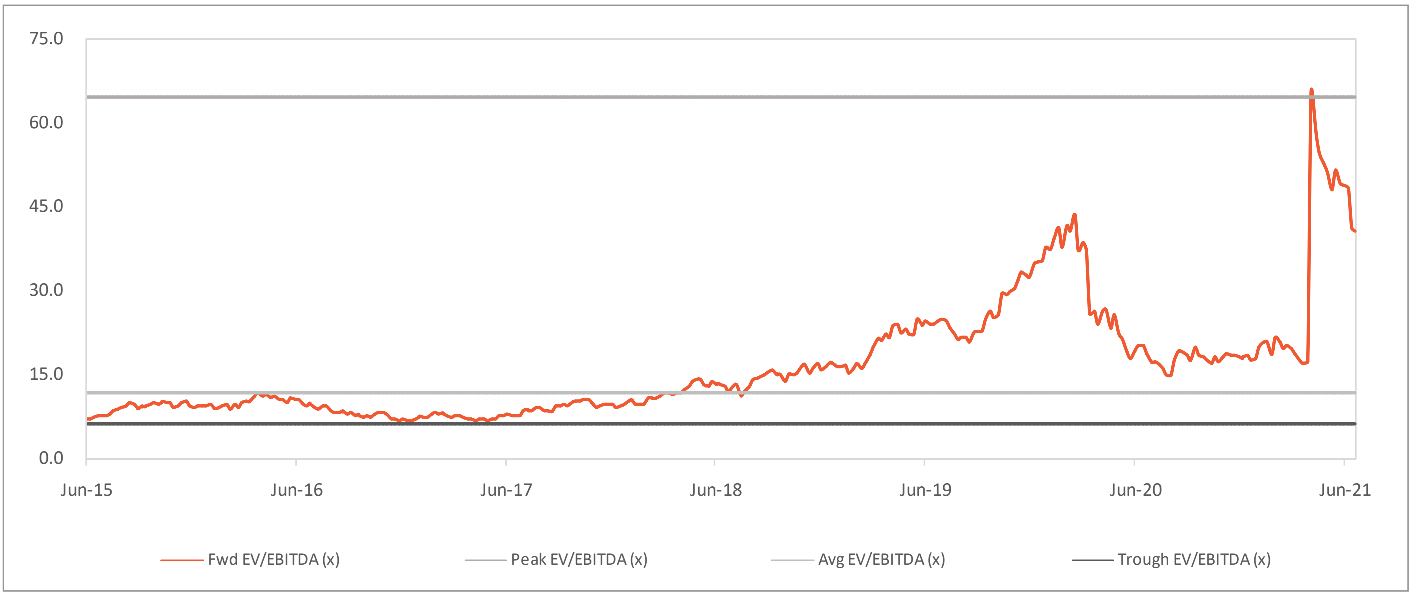
We have maintained our volume and earnings estimates, as we expect the volumes to recover, despite the business getting adversely impacted in May-June'21 due to second wave of COVID-19. We expect ALL's EBIDTA margin will improve aided by benefits arising from operating leverage and cost-cutting initiatives taken up by the company. Further, the company is well poised to benefit from the growth in infrastructure, mining and e-commerce. In the M&HCV space, the company has increased its market share to 28.9% in Q4FY21 from 28.1% in Q3FY21. We remain positive on ALL and expects it to be beneficiary of upturn in CV cycle. We expect the company's earnings to turnaround in FY22E with a net profit of Rs859.5 crore as against a net loss of Rs 301.6 crore in FY21, aided by 48% growth in revenues and sharp margin expansion. The stock is trading below its average historical multiple at P/E of 17.7x and EV/EBITDA of 9.9x its FY2023E estimates. We retain our Buy rating on the stock with an unchanged PT of Rs151

Price Target calculation

Particulars	Rs/Share
FY23E EBITDA (Rs cr)	3,593
Target EV/EBITDA Multiple (x)	12
Equity Value (Rs cr) - Core business	41,631
Equity Value (Rs/share) - Core business	143
HFL's Value (Rs/share)	9
Fair Value of ALL Entity	**151**
Upside (%)	**22%**

Source: Company Data; Sharekhan Research

One-year forward EV/EBITDA (x) band



Source: Company; Sharekhan Research

Peer Comparison

Particulars	CMP (Rs)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Ashok Leyland	124	-	42.7	17.8	69.3	18.1	9.9	-	10.4	21.7
Tata Motors	340	-	14.2	10.3	4.5	3.3	2.9	2.8	4.5	8.8
Mahindra & Mahindra	795	24.5	18.3	15.6	13.7	10.3	8.6	13.6	16.0	17.1

Source: Company; 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

- Prolonged 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 and Chief Executive Officer
Gopal Mahadevan	Director and Chief Financial Officer
K M Balaji	Vice President – Corporate Finance

Source: Company

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Hinduja Automotive Ltd	34.7
2	Citibank NA	11.2
3	Hinduja Bank Switzerland	4.9
4	Mirae Asset Fund	2.5
5	Nippon Life India Trustee Ltd	2.3
6	Schroder International Selection Fund	1.8
7	Platinum International Fund	1.6
8	Matthews Pacific Tiger Fund	1.5
9	Life Insurance Corp of India	1.4
10	HDFC Life Insurance	1.0

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

Sharekhan

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