Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Ashok Leyland Ltd

Strong road ahead

Automobiles	Sharekhan code: ASHOKLEY
Reco/View: Buy ↔	CMP: Rs. 127 · Price Target: Rs. 180 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

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		↔	

ESG Disclosure Score NEW

ESG RISK RATING 37.97

Updated Feb 08, 2022

High Risk

NEGL	LOW	MED	HIGH	SEVERE
0-10	10-20	20-30	30-40	40+

Source: Morningstar

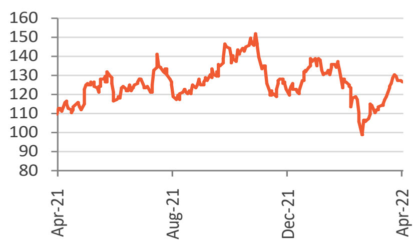
Company details

Market cap:	Rs. 37,281 cr
52-week high/low:	Rs. 153/93
NSE volume: (No of shares)	175 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Free float: (No of shares)	143.49 cr

Shareholding (%)

Promoters	51.1
FII	14.9
DII	20.6
Others	13.4

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	15.5	-8.5	-6.4	13.1
Relative to Sensex	14.2	-0.8	-1.0	-4.8

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Ashok Leyland Limited (ALL) with an unchanged PT of Rs. 180, owing to growth recovery in the CV industry, led by improvement in economic and infrastructure activities.
- ALL is expected to benefit from its aggressive strategy of growing its market share through increased penetration across all regions and new product launches.
- ALL's subsidiary, Switch Mobility Limited is likely to be a beneficiary of EV mobility movement; it has established strong presence in the UK, India, and Continental Europe.
- The stock is trading below its average historical multiples at P/E of 11.2x and EV/EBITDA of 7.7x its FY2024E estimates.

We maintain our positive view on Ashok Leyland Limited (ALL) and expect it to be a strong beneficiary of recovery in commercial vehicle (CV) sales in domestic markets, led by improving macro environment, higher infrastructure spending, and replacement demand. ALL is well placed in the industry to benefit from the expected upcycle in the CV industry, aided by its focus on growing its market share through increased penetration across all regions and new product launches. The company expects good opportunities to continue to grow exports, defence, power solutions, light commercial vehicles (LCV), and parts business even as it expands the reach and products of the core medium and heavy commercial vehicle (MHCV) business. ALL's subsidiary, Switch Mobility Limited (SML) is likely to be a beneficiary of electric vehicle (EV) mobility movement through its strong presence in the UK, India, and Continental Europe. We expect ALL's profitability to improve significantly, with its EBITDA growing at a 166% CAGR for FY2021-FY2023E, led by sharp improvement in operating leverage. Thus, we remain positive on ALL's growth prospects and retain our Buy rating on the stock with an unchanged price target (PT) of Rs. 180.

- **Direct beneficiary of increasing economic activities:** We expect ALL to be a direct beneficiary of recovery in CV sales in domestic markets, led by improving macro environment, higher infrastructure spending, and replacement demand. We expect the domestic CV industry to post a 22% CAGR from FY2022E-FY2025E, where we expect ALL to improve its market share to ~20% from current 16%, led by new product launches in LCV and M&HCVs and increasing the distribution network in North and East regions.
- **Improving fortunes of EV portfolio:** ALL continues to focus on greener technology with renewed focus on EV products. The company's EV subsidiary, SML has made inroads in the UK, India, and Continental Europe. SML is setting up a new advanced manufacturing facility in Valladolid, Spain, which is expected to produce buses in a year's time. The EV subsidiary is looking out for partners and strategic investors, which will put growth on faster track.
- **Improving operating leverage to improve margins:** The company's EBITDA margin is expected to improve significantly from 3.5% in FY2021 to 12.7% in FY2023E, leading to a robust 166% CAGR in EBITDA during FY2021-FY2023E. EBITDA margin is expected to improve because of operating leverage benefits and cost reduction.

Our Call

We expect ALL to benefit from faster recovery in CV volumes and improvement in EBITDA margins, led by operating leverage benefits. ALL is well placed in the industry to benefit from increased economic activities related to infrastructure, mining, and e-commerce, aided by its focus on growing its market share through increased penetration across all regions and new product launches. The company's profitability is expected to improve significantly in the medium term, with its EBITDA expected to post a 166% CAGR over FY2021-FY2023E. Investments by investors and strategic partners in its EV subsidiary can lead to value unlocking and re-rating of the stock going forward. The stock is trading below its average historical multiples at P/E of 11.2x and EV/EBITDA of 7.7x its FY2024E estimates. We reiterate our Buy rating on the stock with an unchanged PT of Rs. 180.

Key Risks

Pricing pressures to defend domestic market share would affect margins.

Valuation (Standalone) Rs cr

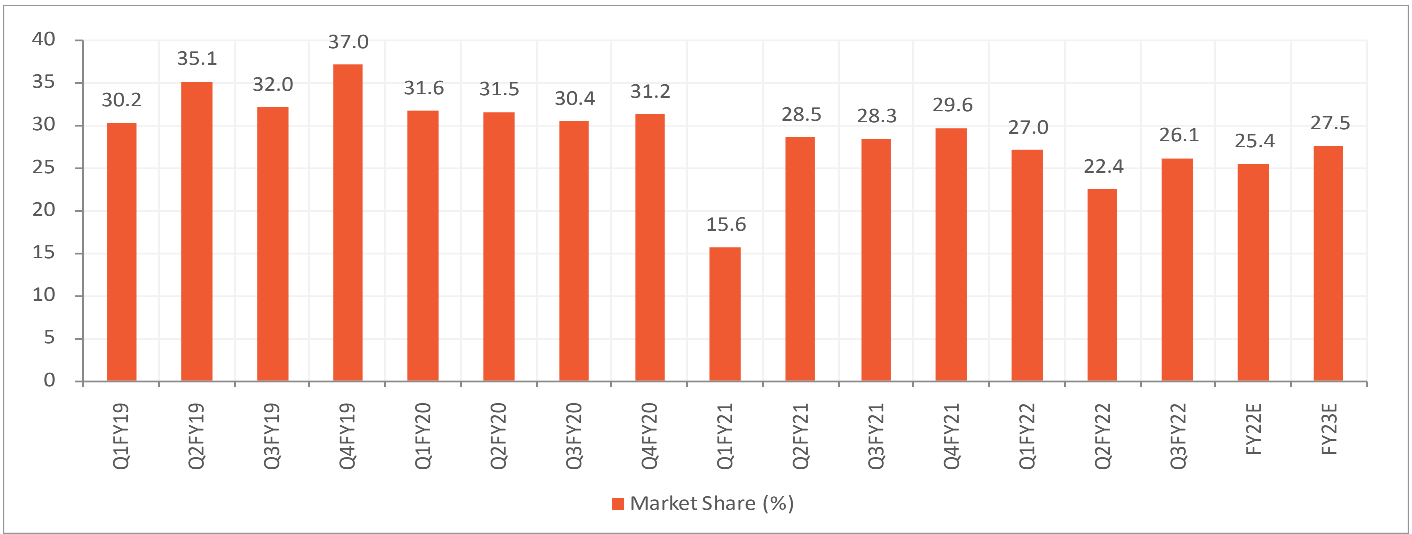
Particulars	FY21	FY22E	FY23E	FY24E
Revenues	15,301	22,799	29,867	34,347
Growth (%)	(12.4)	49.0	31.0	15.0
EBIDTA	535	2,082	3,789	4,449
OPM (%)	3.5	9.1	12.7	13.0
Net Profit	(302)	890	2,198	3,315
Growth (%)	(176.3)	-	147.0	50.8
EPS	(1.0)	3.0	7.5	11.3
P/E	NA	41.9	17.0	11.2
P/BV	5.4	5.0	4.2	3.3
EV/EBIDTA	72.1	18.2	9.5	7.7
ROE (%)	-	12.1	24.8	29.0
ROCE (%)	-	10.7	21.5	26.5

Source: Company; Sharekhan estimates

Direct beneficiary of increasing economic activities: We expect ALL to be a direct beneficiary of recovery in CV sales in domestic markets, led by improving macro environment, higher infrastructure spending, and replacement demand. We expect the domestic CV industry to post a 22% CAGR from FY2022E-FY2025E, where we expect ALL to improve its market share to ~20% from 16% currently, led by new product launches in LCV and M&HCVs and increasing distribution network in north and east regions. The company witnessed faster growth in higher tonnage trucks, led by increased construction and mining activities.

Strong position in M&HCVs; Focus on improving the non-cyclical truck business: ALL is the second largest MHCV manufacturer with a 32% market share. In MHCV buses, ALL is the market leader commanding a 45% market share, 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. 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.

ALL's market shares to improve led by new launches and increasing distribution network



Source: Company; Sharekhan Research

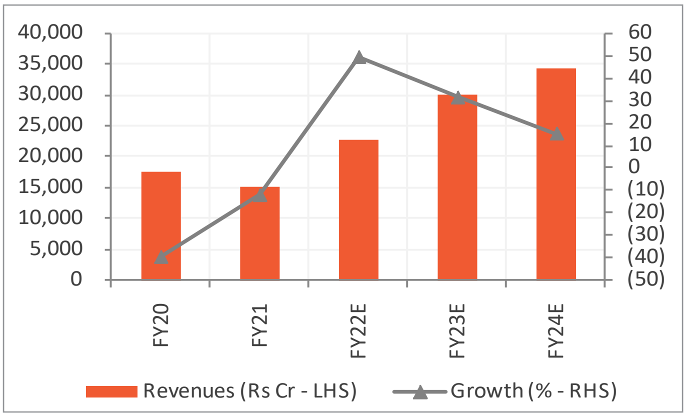
Improving fortunes of EV portfolio: ALL continues to focus on greener technology with renewed focus on EV products. The company's EV subsidiary, SML has made inroads in the UK, India, and Continental Europe. SML is setting up a new advanced manufacturing facility in Valladolid, Spain, which is expected to produce buses in a year's time. The plant will comprise two state-of-the-art production lines and will be entirely carbon neutral from inception. With Euro 100 million of investment planned for the site over the next decade, the facility will play a key role in rejuvenating Soto de Medinilla area around Valladolid. Phase-1 of the new development will house production of SML's new 12 metre bus, designed for the European market. Phase-2 and Phase-3 will add battery-assembly capabilities and production of SML's zero-carbon LCV from 2024. We believe SML is well poised to benefit from increasing requirements of EVs in Europe. The EV subsidiary is looking out for partners and strategic investors, which will put growth on a faster track. Currently, SML has an order book of over 500 electric buses.

Export continues to remain the prime focus: ALL remains focused on exports, which currently contribute 8-10% in terms of volumes. The company's key focus markets are Africa and MENA regions. The company has on boarded 6-7 dealers, who have previous experience in the automobile business and are local. In terms of organisation structure, all markets have separate CEO and manager for focussed approach. The strategy would be to create market and brand recall in cities for its LCV products and increase penetration; then the company would subsequently launch intermediate commercial vehicles (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. In exports, the company is improving base in Africa and Middle East, while strengthening its position in SAARC countries.

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 ICVs. 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. The company's EBITDA margin is expected to improve significantly from 3.5% in FY2021 to 12.7% in FY2023E, leading to a robust 166% CAGR in EBITDA during FY2021-FY2023E. EBITDA margin is expected to improve because of operating leverage benefits and cost reduction. Moreover, the company's earnings are expected to turnaround in FY2022E with net profit of Rs. 890 crore as against net loss of Rs. 301.6 crore in FY2021.

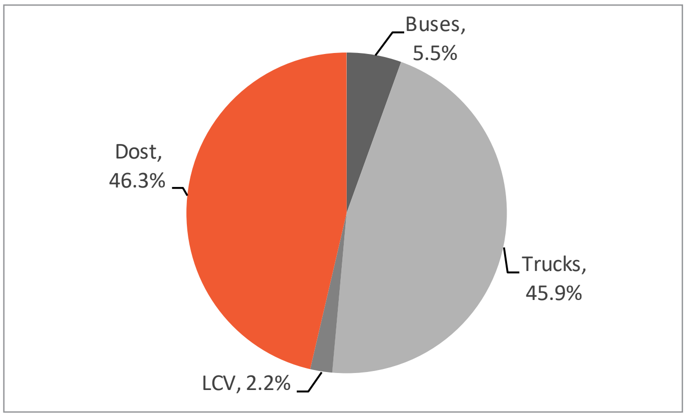
Financials in charts

Revenue and Growth Trend



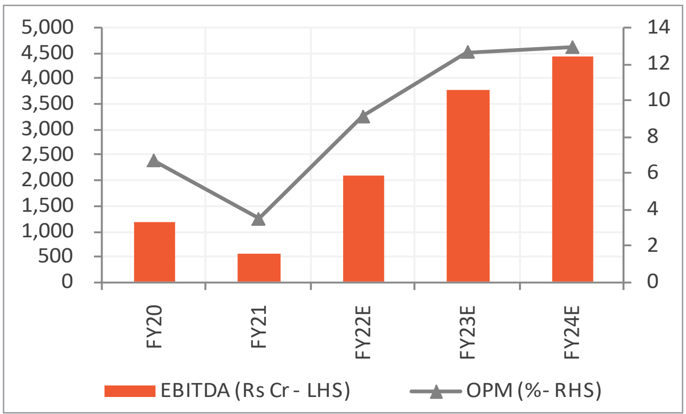
Source: Company, Sharekhan Research

Volume Mix (%)



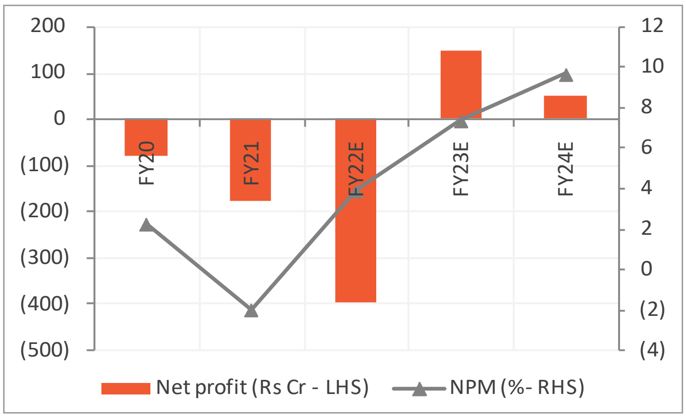
Source: Company, Sharekhan Research

EBITDA and OPM Trend



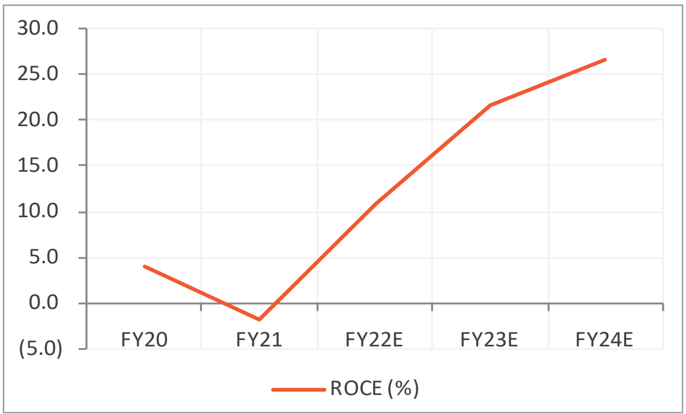
Source: Company, Sharekhan Research

Net Profit and NPM Trend



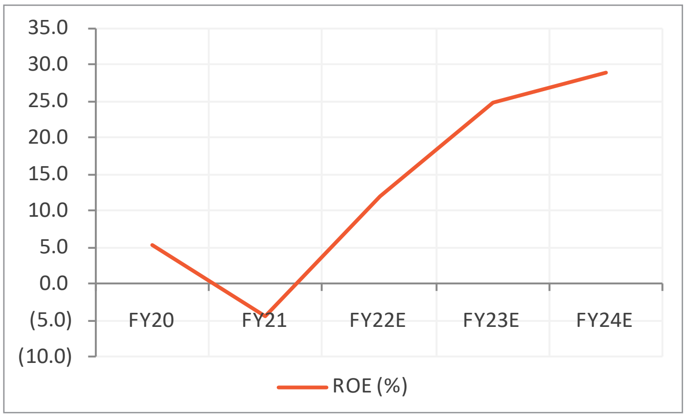
Source: Company, Sharekhan Research

RoCE Trend



Source: Company, Sharekhan Research

RoE Trend



Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Expect recovery in CV sales

We see strong underlying demand for CVs domestically. We expect the strongest recovery in the CV segment in FY2022 and FY2023, driven by improved economic activities, low interest rate regime, and better financing availability. We expect strong improvement in M&HCV sales to continue, driven by rise in e-commerce, agriculture, infrastructure, and mining activities post normalisation of COVID.

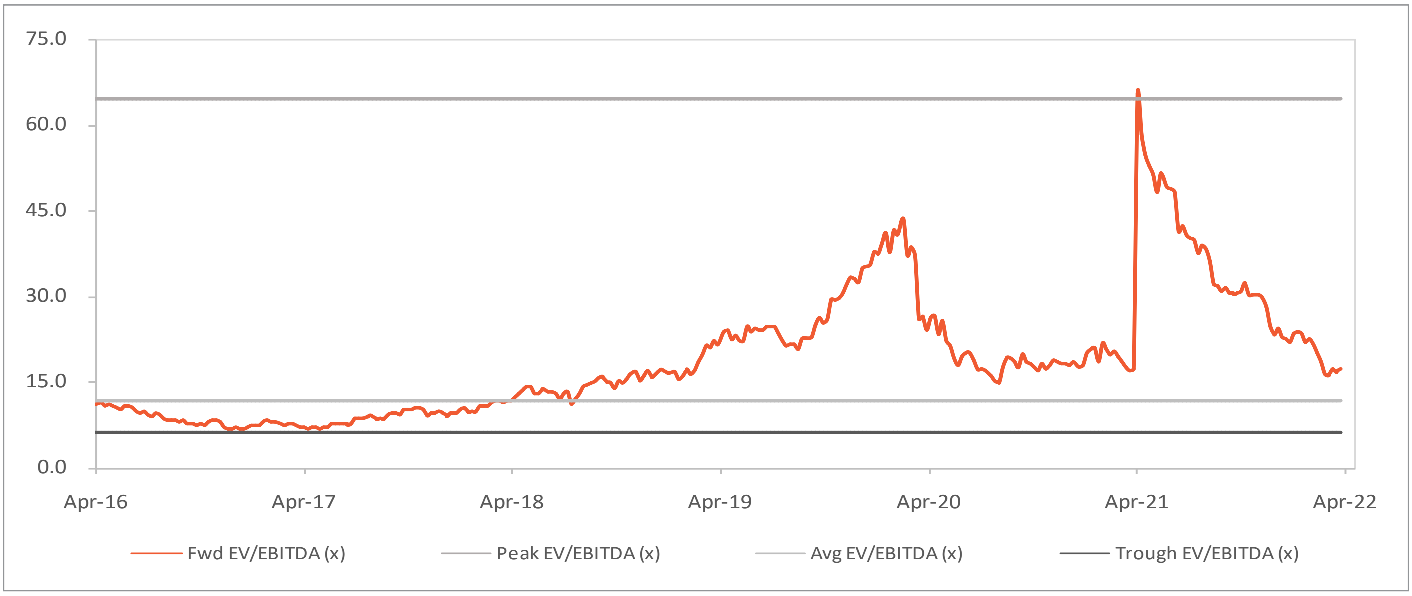
■ Company outlook - Growth strategies in place to drive growth in the medium term

ALL is likely to be the key beneficiary from the expected recovery in the 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. Demand for the passenger segment is set to improve after the opening of schools and offices and normalcy of other activities. The vaccination drive would further help in advancing demand for passenger vehicles. Moreover, normalisation of hygiene and social distancing would lead to less passengers in a bus, which would add to bus demand in the long term. The company is well placed to benefit 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. 180

We expect ALL to benefit from faster recovery in CV volumes and improvement in EBITDA margins, led by operating leverage benefits. ALL is well placed in the industry to benefit from increased economic activities related to infrastructure, mining, and e-commerce, aided by its focus on growing its market share through increased penetration across all regions and new product launches. The company's profitability is expected to improve significantly in the medium term, with its EBITDA expected to post a 166% CAGR over FY2021-FY2023E. Investments by investors and strategic partners in its EV subsidiary can lead to value unlocking and re-rating of the stock going forward. The stock is trading below its average historical multiples at P/E of 11.2x and EV/EBITDA of 7.7x its FY2024E estimates. We reiterate our Buy rating on the stock with an unchanged PT of Rs. 180.

One-year forward EV/EBITDA (x) band



Source: Sharekhan Research

Peer Comparison

Companies	CMP (Rs)	P/E (x)			EV/EBITDA (x)			ROCE (%)		
		FY21	FY22E	FY23E	FY21	FY22E	FY23E	FY21	FY22E	FY23E
Ashok Leyland	127	-	41.9	17.0	72.1	18.2	9.5	-	10.7	21.5
Tata Motors	436	-	-	15.1	7.2	6.7	4.7	4.7	-	8.5
Mahindra & Mahindra	882	26.8	20.7	17.5	14.9	11.7	9.7	13.8	15.7	16.9

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 overall 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 a 32% market share. In MHCV buses, ALL is the market leader commanding a 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.

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

by BNP PARIBAS

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