Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update | Result Update

Ashok Leyland Ltd

On a firm track

Automobiles		Sharekhan code: ASHOKLEY	
Reco/View: Buy	↔	CMP: **Rs. 154**	Price Target: **Rs. 181** ↑

↑ 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 37.92

Updated Jul 08, 2022

High Risk

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

Source: Morningstar

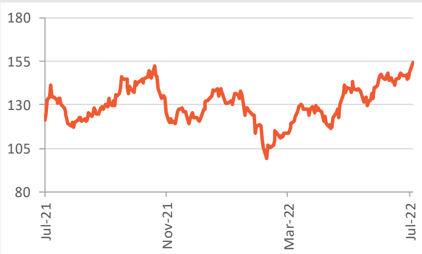
Company details

Market cap:	Rs. 45,207 cr
52-week high/low:	Rs. 158 / 93
NSE volume: (No of shares)	10.7 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Free float: (No of shares)	143.49 cr

Shareholding (%)

Promoters	51.1
FII	14.9
DII	21.6
Others	12.3

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	4.3	22.3	11.5	27.0
Relative to Sensex	-5.3	20.3	13.1	16.1

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Ashok Leyland Limited (ALL) with a revised PT of Rs 181, owing to its market share gains across segments and improving demand of buses.
- Q1FY23 results were below expectations, marred by negative operating leverage and commodity price inflation. EBITDA margin for Q1FY23 contracted 440bps q-o-q to 4.4%, led by negative operating leverage benefits and commodity price inflation.
- ALL is expected to benefit from its aggressive strategy of growing its market share through increased penetration across all regions, new product launches and well placed to benefit from e-mobility movement.
- The stock is trading at P/E of 21.4x and EV/EBITDA of 12.1x its FY2024E estimates.

Ashok Leyland (ALL) reported weak numbers, largely due to negative operating leverage. Standalone net revenues were down by 17.4% q-o-q to Rs7,223 crore, led by a decline of 18.6% in volumes, partially mitigated by 1.5% improvement in average sales realization. EBITDA margin declined 280bps lower than expectations at 4.4%, led by negative operating leverage benefits and commodity price inflation. As a result, EBITDA and PAT for Q1FY23 declined 58.7% q-o-q and 87.2% q-o-q to Rs320 crore and Rs55 crore respectively. We continue to maintain our positive view on ALL and expect it to be a strong beneficiary of recovery in commercial vehicle (CV) sales in domestic markets, led by an improving macro environment, higher infrastructure spending, and replacement demand. 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 the 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 91.6% CAGR for FY2022-FY2024E, led by a sharp improvement in operating leverage. Thus, we remain positive on ALL's growth prospects and retain our Buy rating on the stock with a revised price target (PT) of Rs181.

Key positives

- ALL's market share improved across the segments in M&HCVs and LCVs, driven by the success of the AVTR range of trucks and the launch of the CNG range in ICVs.
- The company witnessed faster growth in higher tonnage trucks, led by an increase in construction and mining activities.

Key negatives

- EBITDA margin declined 280bps lower than expectations at 4.4%, led by negative operating leverage benefits and commodity price inflation.
- Semi-conductor shortage- continues to impact LCV sales. The company estimates a loss of 500-1000 vehicles in Q1 due to ECU shortage.

Management Commentary

- The management gave a positive outlook for the CV industry and continues to grow opportunities for exports, defence, power solutions, LCV and parts business even as it expands the reach and products of the core MHCV business.
- The company expect commodity prices to soften in Q2FY23, after an increase of 5-6% in raw material costs in Q1FY23. The company had taken vehicle price hikes of 1.7%-2% during Q1.
- The management continues to focus on greener technology with a renewed focus on EV products. The company continues to launch CNG variants.
- The company had a capex of Rs115 crore in Q1FY23 and maintains its guidance of Rs750 crore capex in FY23E.
- The bus segment is showing signs of strong recovery and is expected to show strong sales growth in FY23E, led by the opening of educational institutions and corporate offices across the country.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 181: We expect ALL to benefit from the 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 21.4x and EV/EBITDA of 12.1x its FY2024E estimates. We retain our Buy rating on the stock with a revised PT of Rs181.

Key Risks

Pricing pressures to defend domestic market share would affect margins.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E
Revenues	15,301	21,688	28,303	33,964
Growth (%)	(12.4)	41.7	30.5	20.0
EBIDTA	535	995	2,715	3,651
OPM (%)	3.5	4.6	9.6	10.7
Net Profit	(302)	31	1,355	2,114
Growth (%)	(176.3)	NA	NA	56.0
EPS	(1.0)	1.8	4.6	7.2
P/E	NA	83.6	33.4	21.4
P/BV	6.6	6.9	6.3	5.3
EV/EBIDTA	87.0	46.8	16.8	12.1
ROE (%)	(4.4)	0.5	19.0	24.8
ROCE (%)	(1.8)	2.1	15.9	20.6

Source: Company; Sharekhan estimates

Weak performance in Q1FY23: Ashok Leyland (ALL) reported weak numbers, largely due to negative operating leverage. EBITDA margin declined 280bps lower than expectations at 4.4%, impacting overall profitability of the company in Q1FY23. Standalone net revenues were down by 17.4% q-o-q to Rs7,223 crore, led by a decline of 18.6% decline in volumes, partially mitigated by an 1.5% improvement in average sales realization. The volume decline was driven by seasonality. The improvement in average sales realisation was aided by price hikes and improvement in product mix. EBITDA margin for Q1FY23 contracted 440bps q-o-q to 4.4%, led by negative operating leverage benefits and commodity price inflation. The EBITDA margin was impacted as a result of 110bps q-o-q increase in raw material cost, 120bps increase in employee costs and 220bps increase in other operating expenses. The raw material cost inflation during the Q1FY23 was around 5-6%, while the company had taken 1.7-2% price hikes during the quarter. As a result, EBITDA and PAT for Q1FY23 declined 58.7% q-o-q and 87.2% q-o-q to Rs320 crore and Rs55 crore respectively.

Improvement in ALL's market share in the truck segment: ALL's market share continues to improve across segments, driven by the success of the AVTR range of trucks and the launch of the CNG range in ICVs. The demand for M&HCVs and ICVs remains buoyant backed by strong performance in core sectors such as infrastructure, mining and e-commerce sectors. The government's increased allocations and spending would further put a thrust on the growth. The management expects the CV segment to do well over the next 3-4 years. The LCV is also performing well and is likely to benefit from the growth in the last mile.

Bus segment: The bus segment is showing signs of strong recovery and is expected to show strong sales growth in FY23E, driven by normalcy in the economy. ALL is a leader in the bus segment and is expected to see strong growth in the bus sub-segment.

Switch mobility: The company's EV subsidiary, Switch Mobility Ltd. (SML) has made inroads in the UK, India, and Continental Europe. ALL (SWITCH) has current STU orders of ~655 e-buses in Bengaluru, Mumbai, Gujarat, Chandigarh and Bihar. Currently, there are SWITCH's 115 e-buses running across three cities in India – Chandigarh, Patna and Ahmedabad. Also, Switch has expanded to nine States across three countries – UK, Spain and India. ALL continues to focus on greener technology with a renewed focus on EV products. 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 the Soto de Medinilla area around Valladolid. Phase-1 of the new development will house the 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 the increasing requirements for EVs in Europe. The EV subsidiary is looking out for partners and strategic investors, which will put growth on a faster track.

Exports: International operations saw a growth of 75.3% y-o-y in Q1FY23 to 2,527 units in the CV segment and remains a focus area for the company. 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 its base in Africa and the Middle East, while strengthening its position in SAARC countries.

Management outlook: The management is positive for growth in the medium term, on the back of continued growth in infrastructure growth in the country. 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. 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 the demand for passenger vehicles. Also, the normal hygiene and social distancing would lead to fewer passengers in a bus, which would add to bus demand in the medium term. Management continues to focus on greener technology with a renewed focus on EV products. The company expects industry demand to improve as the economy opens up and business activities gain momentum.

Focus on digitisation and new launches: ALL's focus on digitisation remains a 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 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. The company launched 4 AVTR range of M&HCV trucks and 2 CNG variants of Ecomet in the truck segment during Q4FY22. Further, the company plans to launch the development of CNG/LNG products across the range including DOST, BADA Dost, ECOMET, AVTR and buses.

Positive outlook going forward: The company expects the industry demand to improve as the economy opens up and business activities gain momentum. ALL expect 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 showing strong signs of recovery. ALL are 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 going forward. We expect ALL's profitability to improve significantly, with its EBITDA growing at a 91.6% CAGR for FY2022-FY2024E, led by a sharp improvement in operating leverage.

Results (Standalone) — Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Net sales	7,223	2,951	144.8	8,744	(17.4)
Total operating expenses	6,903	3,091	123.3	7,968	(13.4)
Operating profit	320	(140)	NA	776	(58.7)
Depreciation	182	183	(0.6)	195	(6.6)
Interest	69	71	(2.6)	76	(9.9)
Other Income	26	13	91.3	24	6.1
PBT	95	(381)	NA	528	(82.1)
Tax	40	(100)	NA	97	(59.3)
Reported PAT	68	(281)	NA	901	(92.5)
Adjusted PAT	55	(282)	NA	431	(87.2)
Recurring EPS	0.2	-1.0	NA	1.5	(87.2)

Source: Company; Sharekhan Research

Key ratios (Standalone) — Rs cr

Particulars	Q1FY23	Q1FY22	Y-o-Y (bps)	Q4FY22	Q-o-Q (bps)
Gross margin (%)	20.7	25.9	(520)	21.8	(110)
EBIDTA margin (%)	4.4	(4.7)	NA	8.9	(440)
EBIT margin (%)	1.9	(11.0)	NA	6.6	(470)
Net profit margin (%)	0.8	(9.6)	NA	4.9	(420)
Effective tax rate (%)	42	26	1,550	18.4	2,340

Source: Company; Sharekhan Research

Volume Analysis — (Rs per Vehicle)

Particulars	Q1FY23	Q1FY22	Y-o-Y %	Q4FY22	Q-o-Q %
Volumes (units)	39,651	17,987	120.4	48719	(18.6)
Realisation	18,21,606	16,40,624	11.0	17,94,842	1.5
RM/vehicle	14,44,617	12,16,017	18.8	14,04,415	2.9
Gross Profit/Vehicle	3,76,989	4,24,607	(11.2)	3,90,427	(3.4)
EBITDA/Vehicle	80,775	-77,890	NA	1,59,289	(49.3)
PAT/vehicle	13,881	-1,56,941	NA	88,489	NA

Source: Company; Sharekhan Research

Outlook and Valuation

Sector Outlook – Expect a strong recovery in CV sales

We see strong underlying demand for CVs domestically. We expect a strong recovery in the CV segment in FY2023 and FY2024, driven by improved economic activities, better financing availability and increasing profitability of truck and bus operators. We expect strong improvement in M&HCV sales to continue, driven by a rise in e-commerce, agriculture, infrastructure, and mining activities post normalisation of COVID.

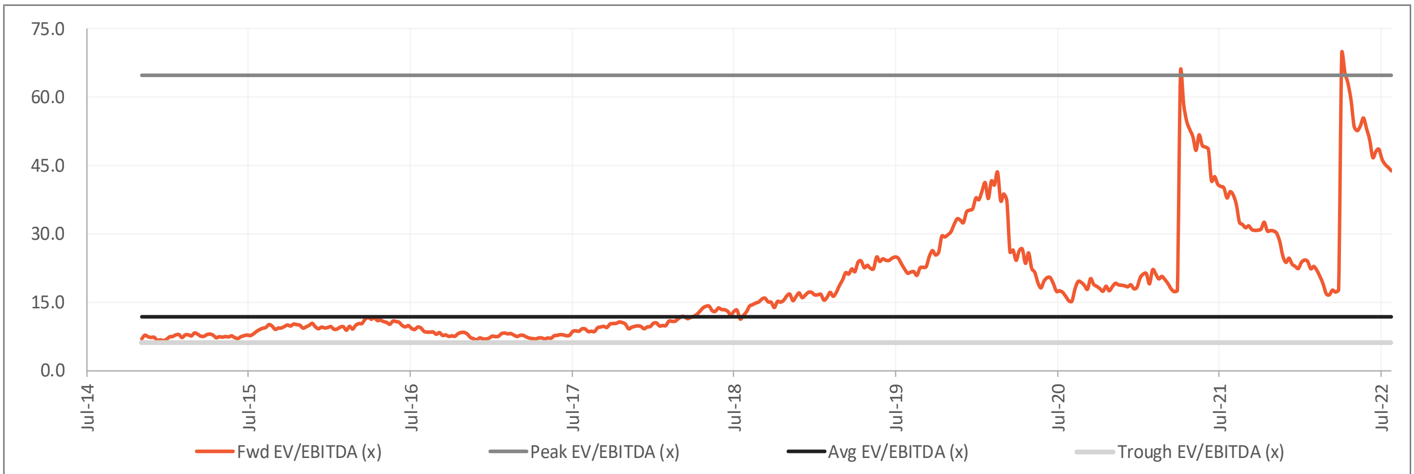
Company Outlook – Growth strategies in place to drive growth in medium term

ALL is likely to be the key beneficiary of 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 the normalcy of other activities. The vaccination drive would further help in advancing the demand for passenger vehicles. Moreover, normalisation of hygiene and social distancing would lead to fewer 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 a revised PT of Rs.181

We expect ALL to benefit from a 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 ifrastructure, 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 21.4x and EV/EBITDA of 12.1x its FY2024E estimates. We retain our Buy rating on the stock with a revised PT of Rs181.

One-year forward EV/EBITDA (x) band



Source: Company, Sharekhan Research

Peer Comparison

Particulars	CMP	P/E (x)			EV/EBITDA (x)			RoCE (%)		
	Rs/Share	FY22	FY23E	FY24E	FY22	FY23E	FY24E	FY22	FY23E	FY24E
Ashok Leyland	154	83.6	33.4	21.4	46.8	16.8	12.1	2.1	15.9	20.6
Tata Motors	479	NA	26.0	15.1	9.4	6.5	5.1	1.2	5.7	13.7
Mahindra & Mahindra	1236	28.8	23.6	19.2	20.7	15.2	12.2	13.8	15.7	16.9

Source: Company, Sharekhan estimates

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 to the balance 13%.

Investment theme

We believe the CV industry is poised for an upturn in the market due ta o 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 the 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 purchases 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

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 Website

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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