Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Ashok Leyland Ltd

Reviving up for higher growth

Automobiles	Sharekhan code: ASHOKLEY
Reco/View: Buy ↔	CMP: **Rs. 152** / 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 Dec 08, 2022

High Risk

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

Source: Morningstar

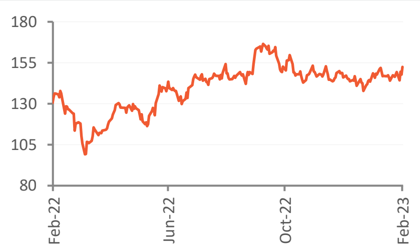
Company details

Market cap:	Rs. 44,033 cr
52-week high/low:	Rs. 169/93
NSE volume: (No of shares)	1.2 crore
BSE code:	500477
NSE code:	ASHOKLEY
Free float: (No of shares)	142.29 cr

Shareholding (%)

Promoters	51.5
FII	21.2
DII	15.3
Others	12.0

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	2.5	2.0	5.1	16.4
Relative to Sensex	4.5	3.6	-3.3	11.6

Sharekhan Research, Bloomberg

Summary

- We retain our Buy rating on Ashok Leyland Limited (ALL) with an unchanged PT of Rs 181, owing to its market share gains in MHCV segment and strong operating performance.
- Q3FY2023 results was above expectations as ALL reported 230 bps q-o-q expansion in EBITDA margin led by healthy product mix and commodity cost benefit.
- 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 at P/E of 18x and EV/EBITDA of 10.5x its FY2025E estimates.

Ashok Leyland (ALL) displayed robust performance in Q3FY2023 on the back of a correction in raw material prices and a better product mix. Revenue and EBITDA were 1.8% and 19.9% ahead of our estimates. Revenue increased by 9.2% q-o-q to Rs 9,030 cr, led by 5.0% q-o- q growth in volumes and 4.0% q-o-q growth in realisations. The improvement in realisation is attributed to a better product mix and price hike. EBITDA increased by 48.4% q-o-q, and EBITDA margin expanded by 230 bps q-o-q to 8.8% (against our estimate of 7.5%) led by (1) 170 bps q-o-q expansion in gross margin (2) operating leverage (3) better product mix and (4) adequate price hikes. With this operating performance, APAT has increased by 85.5% q-o-q to Rs 354 cr. 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 benefit from the electric vehicle (EV) mobility movement through its strong presence in the UK, India, and Continental Europe. 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

- EBIDTA margin expanded by 230 bps q-o-q to 8.8% led by 170 bps q-o-q gross margin expansion and operating leverage
- ALL has been consistently maintaining its market share above 30% in the MHCV segment, as this was the consecutively fourth quarter when ALL's market share stood above 30% level.
- With improvement in operating profitability, the net debt has come down to 2043 cr (vs Rs 2,677 cr in Q3FY2022), and working capital has come down to Rs 365 cr (vs Rs 490 cr in Q3FY2022)

Key negatives

- Export markets are still facing headwinds
- Delay in fundraising in its EV projects (switch mobility)

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 or remain steady in Q4FY2023
- ALL is hoping to continue to gain market share without compromising the underline profitability
- The company had a capex of Rs320 crore in 9mFY2023and guided for a capex of Rs 600 cr for FY2023E
- The bus segment is showing signs of strong recovery. It is expected to show strong sales growth in FY2023E, led by the opening of educational institutions and corporate offices across the country.

Our Call

Valuation - Maintain Buy with an unchanged PT of Rs. 181: Post reporting strong performance in Q3FY2023 the management has shared its optimistic outlook for domestic MHCV segment and aims for a profitable market share gain strategy. We expect ALL to benefit from the faster recovery in CV volumes and improved EBITDA margins, led by operating leverage benefits and correction in commodity costs. 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. Investments by investors and strategic partners in its EV subsidiary can lead to value unlocking and re-rating the stock going forward. The stock is trading at a P/E of 18x and EV/EBITDA of 10.5x its FY2025E estimates. We retain our Buy rating on the stock with an unchanged PT of Rs181.

Key Risks

Pricing pressures to defend domestic market share would affect margins and adverse macroeconomic trend.

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23E	FY24E	FY25E
Revenues	15,301.5	21,688.3	33,718.5	40,462.2	46,531.5
Growth (%)	-12.4	41.7	55.5	20.0	15.0
EBIDTA	535.1	994.5	2,483.2	3,421.6	4,113.6
OPM (%)	3.5	4.6	7.4	8.5	8.8
Net Profit	(301.6)	31.0	967.3	1,927.8	2,480.7
Growth (%)	-	-	3020.3	99.3	28.7
EPS	(1.0)	1.8	3.3	6.6	8.5
P/E	NA	82.3	46.1	23.1	18.0
P/BV	6.5	6.8	6.6	5.6	4.6
EV/EBIDTA	85.7	46.1	18.1	12.7	10.5
ROE (%)	-4.4	0.5	14.3	24.3	25.7
ROCE (%)	(1.8)	2.1	14.0	19.0	20.7

Source: Company; Sharekhan estimates

Gained 730 bps market share in MHCV segment: With a strong product profile and network expansion, ALL has been maintaining its market share above 30% levels for the last four quarters and gained 730 bps y-o-y market in Q3FY2023. ALL's market share stood at 32.6% in Q3FY2023 compared to 25.3% in Q3FY2022. The dealership network expansion has helped ALL in gaining market share in North and East regions also, which used to be weak markets for ALL. As per the management, the freight rates have been assumed to be firm excepts some aberrations and the demand is coming from across the sectors. Tipper, haulage and tractor trailer segments continue to be strong, and demand is shifting towards high tonnage segments. Further, the bus segment is gradually opening.

Improving balance sheet: With improvement in operating performance, the net debt has reduced by Rs 635 cr to Rs 2,043 cr in Q3FY2023 compared to Rs 2,677cr in Q3FY2022. Further, the management foresees a capex of Rs 600 cr in FY2023 as it has already completed a capex of Rs 321 cr in 9MFY2023. The traction in business has translated into a reduction in net working capital. The net working capital stood at Rs 365cr compared to Rs 490 cr in Q3FY2022.

Switch is performing well: The management has indicated that switch mobility is regularly receiving healthy orders in the EV industry and has been actively looking for the right kind of strategic partners. The Switch UK is looking for a European market to open before the beginning of the new product launch cycle. Going forward, the company is planning to launch EV version of bada dost in the Indian market

RM cost trend: The correction in raw material prices has helped ALL register improvement in EBITDA margin in Q3FY2023. Going forward, the management assumes that the raw material cost will remain steady or marginally soft from current levels in Q4FY2023. Further, the company has been rising prices to pass on the higher raw material cost to the customer and to save its EBITDA margins

Results (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Net sales	9,030	5,535	63.1	8,266	9.2
Total operating expenses	8,232	5,311	55.0	7,729	6.5
Operating profit	797	224	256.1	537	48.4
Depreciation	189	190	(0.4)	177	6.9
Interest	80	67	20.3	77	4.3
Other Income	32	18	79.1	20	58.0
PBT	560	(15)	NA	303	84.4
Tax	205	21	863	112	82.5
Reported PAT	361	6	-	199	81.3
Adjusted PAT	354	(36)	-	191	85.5
Recurring EPS	1.2	(0)	-	0.7	85.5

Source: Company; Sharekhan Research

Key ratios (Standalone) Rs cr

Particulars	Q3FY23	Q3FY22	YoY (bps)	Q2FY23	QoQ (bps)
Gross margin (%)	23.7	22.1	170	22.0	170
EBIDTA margin (%)	8.8	4.0	480	6.5	230
EBIT margin (%)	6.7	0.6	610	4.4	240
Net profit margin (%)	3.9	(0.7)	NA	2.3	160
Effective tax rate (%)	36.7	-	NA	37.0	(40)

Source: Company; Sharekhan Research

Volume Analysis (Rs per Vehicle)

Particulars	Q3FY23	Q3FY22	YoY (%)	Q2FY23	QoQ (%)
Volumes (units)	47,562	34,077	39.6	45,295	5.0
Realisation	18,98,505	16,24,310	16.9	18,24,914	4.0
RM/vehicle	14,47,763	12,65,695	14.4	14,23,243	1.7
Gross Profit/Vehicle	4,50,742	3,58,614	25.7	4,01,671	12.2
EBITDA/Vehicle	1,67,642	65,701	155.2	1,18,631	41.3
PAT/vehicle	74,513	-	NA	42,188	76.6

Source: Company; Sharekhan Research

Outlook and Valuation

Sector View – Expect a strong recovery in CV sales

We see a 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.

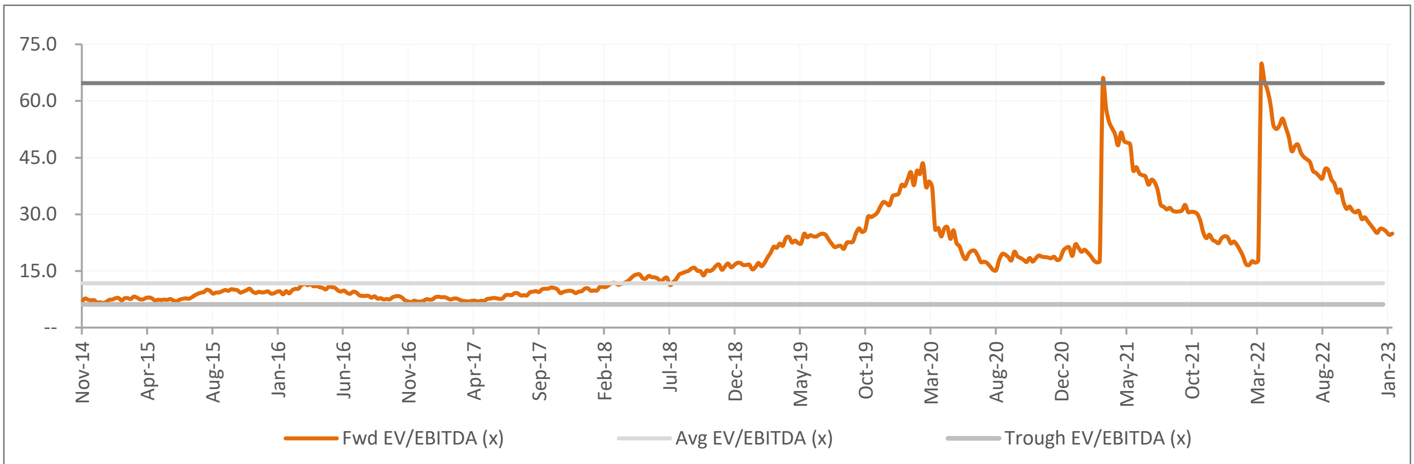
Company Outlook – Growth strategies in place to drive growth in the medium term

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 the 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, the 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 an unchanged PT of Rs.181

Post reporting strong performance in Q3FY2023 the management has shared its optimistic outlook for domestic MHCV segment and aims for a profitable market share gain strategy. We expect ALL to benefit from the faster recovery in CV volumes and improved EBITDA margins, led by operating leverage benefits and correction in commodity costs. 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. Investments by investors and strategic partners in its EV subsidiary can lead to value unlocking and re-rating the stock going forward. The stock is trading at a P/E of 18x and EV/EBITDA of 10.5x its FY2025E estimates. We retain our Buy rating on the stock with an unchanged PT of Rs181.

One-year forward EV/EBITDA (x) band



Source: 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	152	82.3	46.1	23.1	46.1	18.1	12.7	14.0	19.0	20.7
Tata Motors	437	NA	22.9	13.3	10.0	7.8	5.4	(3.9)	2.3	12.9
Mahindra & Mahindra	1,352	31.4	22.5	18.7	22.7	15.0	11.9	19.3	20.7	21.3

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%, while exports contribute to the balance 13%.

Investment theme

We believe the CV industry is poised for an upturn in the market due to a 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 and 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
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	12.0
3	Hinduja Bank Switzerland	4.9
4	Matthews international Capital Mgmt	2.4
5	Vanguard Group	1.8
6	Mirae Asset Fund	1.7
7	Schroder PLC	1.5
8	HDFC Life Insurance	1.4
9	Sundaram AMC	1.4
10	ICICI Pru Life Insurance	1.3

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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