

Ashok Leyland

18 February 2020

Reuters: ASOK.NS; Bloomberg: AL IN

Preparing for an upcycle

Ashok Leyland's (AL) reported 3QFY20 adj PAT of Rs299mn was down ~92% YoY mainly on account of lower EBITDA margin and higher tax rate and was significantly below our estimate. Net revenue of Rs40.1bn, down 36.5% YoY, was below our estimate. ASP declined by 11% YoY and 5.2% QoQ. EBITDA margin stood at 5.6%, down 20bps QoQ and was 90bps below our estimate. This decline was largely driven by a sharp decline in gross margin (450bps QoQ) due to decrease in inventory, as overall dispatches were ~23% higher than production during the quarter. Lower employee costs, due to lower production, helped reduce the impact of the sharp decline in gross margin. Higher interest cost and lower other income, partially offset by lower depreciation led to ~33% QoQ decline in PBT (adj for exceptional item) to Rs5.4bn. Domestic demand scenario continues to remain weak on account of reasons such as (1) continued weak customer sentiment (2) weak economic growth and (3) Industry specific issues – except for road construction, other segments of the infrastructure sector continue to remain weak. Management expects 1HFY21 to continue to witness de-growth as the industry is expected see economic recovery led growth only from 3QFY21 onwards. Demand for Passenger Bus, ITD and LCVs have been better. Management, however, believes that CV industry has bottomed out and will see some recovery from FY21 onwards. AL is using this slowdown as an opportunity to implement some structural measures including cost reduction, focus on productivity and cash flows, and new product development, which management believes will make the company more resilient. The cost reducing program (K54) is on track to save Rs5bn in FY20 and the company is looking at another Rs6.5bn saving in FY21. Management is also focusing on inventory rationalization to facilitate a smooth BS-VI transition. Total inventory (company+dealer) reduced from 27,500 units at the start of the 2QFY20 to ~6,500 now. Inventory would come down to zero by March end. The company will introduce modular platform across its entire product portfolio from April'20 along with BS-VI. Other area that management will focus on is to become asset light. Hence, this year's capex is down to about Rs13bn vs earlier guided Rs18bn. It will focus on higher ROCE segments like exports, LCVs, defense and spare parts to drive profitability growth going forward. We believe that all these measures will help AL when the CV cycle revives. We have revised our volume forecast by -6.3%/-6.3% and PAT forecast by -15.7%/-4.3% for FY21/22E, respectively. We raise our target multiple to 20x from 17x earlier (last 5 year's average one year forward PER is 21x) as we expect a revival in CV cycle from FY21, led by better GDP growth and lower base. Our revised target price is Rs98 and we maintain our BUY rating.

Focusing on higher ROCE segments to drive growth: Ashok Leyland will focus on higher ROCE segments like exports, LCVs, defense and spare parts to drive profitability growth going forward. It is targeting export growth over 20% in FY21 on the back of tender wins in African and Sri Lankan market and demand revival in Bangladesh. The company's new LCV platform 'Phoenix' will be launched by May this year. It is very confident of market share gains on the back of this new platform.

BUY

Sector: Automobiles

CMP: Rs82

Target Price: Rs98

Upside: 20%

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Key Data

Current Shares O/S (mn)	2,935.5
Mkt Cap (Rsbn/US\$bn)	239.4/3.4
52 Wk H / L (Rs)	98/57
Daily Vol. (3M NSE Avg.)	18,479,210

Price Performance (%)

	1 M	6 M	1 Yr
Ashok Leyland	(2.9)	28.1	2.0
Nifty Index	(2.5)	9.0	12.3

Source: Bloomberg

Y/E March (Rsmn)	3QFY19	2QFY20	3QFY20	YoY (%)	QoQ (%)	FY19YTD	FY20YTD	YoY (%)
Net sales	63,252	39,295	40,157	(36.5)	2.2	2,01,833	1,36,290	(32.5)
COGS	44,357	27,133	29,532	(33.4)	8.8	1,43,157	96,402	(32.7)
% of sales	70.1	69.0	73.5	3.4	4.5	70.9	70.7	(0.2)
Gross margin %	29.9	31.0	26.5	(340bps)	(450bps)	29.1	29.3	20bps
Employee costs	5,001	4,321	2,728	(45.4)	(36.9)	15,104	12,053	(20.2)
% of sales	7.9	11.0	6.8	(1.1)	(4.2)	7.5	8.8	1.4
Other expenses	7,398	5,555	5,645	(23.7)	1.6	22,542	17,928	(20.5)
% of sales	11.7	14.1	14.1	2.4	(0.1)	11.2	13.2	2.0
EBITDA	6,496	2,286	2,252	(65.3)	(1.5)	21,031	9,907	(52.9)
EBITDA margin %	10.3	5.8	5.6	(470bps)	(20bps)	10.4	7.3	(310bps)
Depreciation	1,607	1,600	1,575	(2.0)	(1.6)	4,439	4,821	8.6
Interest expenses	192	301	337	75.7	11.8	481	764	58.6
Other income	208	455	223	7.4	(50.9)	989	889	(10.1)
Exceptional exp/(inc)	70	648	22	-	-	439	871	-
PBT	4,836	191	542	(88.8)	183.5	16,661	4,340	(74.0)
Tax	1,027	-198	264	(74.3)	(233.7)	4,556	1,372	(69.9)
Effective tax rate %	21.2	-103.4	48.8	-	-	27.3	31.6	-
Reported PAT	3,808	389	278	(92.7)	(28.6)	12,105	2,968	(75.5)
Adj PAT	3,858	1,037	299	(92.2)	(71.1)	12,413	3,839	(69.1)
Adj PAT margin %	6.1	2.6	0.7	(540bps)	(190bps)	6.1	2.8	(330bps)
EPS	1.3	0.4	0.1	(92.2)	(71.1)	4.2	1.3	(69.1)

Source: Company, Nirmal Bang Institutional Equities Research

Please refer to the disclaimer towards the end of the document.

Exhibit 1: Financial summary

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Volume (units)	1,74,851	1,97,366	1,38,316	1,52,078	1,73,639
YoY growth (%)	20.5	12.9	(29.9)	9.9	14.2
Net sales	2,62,479	2,90,550	2,00,408	2,36,466	2,86,476
YoY growth (%)	31.1	10.7	(31.0)	18.0	21.1
EBITDA	27,390	31,357	15,231	21,755	29,794
EBITDA margin (%)	10.4	10.8	7.6	9.2	10.4
Adjusted PAT	15,748	20,407	6,439	11,168	17,579
EPS	5.4	7.0	2.2	3.8	6.0
YoY change (%)	35.1	29.6	(68.4)	73.4	57.4
RoCE (%)	29.8	29.2	9.5	16.9	23.5
RoE (%)	22.0	24.5	7.9	13.4	19.4
P/E (x)	15.2	11.7	37.2	21.5	13.6
EV/Sales (x)	0.7	0.7	1.0	0.8	0.6
EV/EBITDA (x)	6.4	6.5	13.5	9.1	6.2

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 2: Change in our estimates

Y/E March (Rsmn)	New estimate			Old estimate			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Volume	1,38,316	1,52,078	1,73,639	1,48,101	1,62,367	1,85,294	(6.6)	(6.3)	(6.3)
Net sales	2,00,408	2,36,466	2,86,476	2,28,683	2,59,997	3,09,331	(12.4)	(9.1)	(7.4)
EBITDA	15,231	21,755	29,794	20,581	25,740	32,480	(26.0)	(15.5)	(8.3)
EBITDA margin (%)	7.6	9.2	10.4	9.0	9.9	10.5	(140bps)	(70bps)	(10bps)
Adj PAT	6,439	11,168	17,579	10,407	13,240	18,367	(38.1)	(15.7)	(4.3)

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 3: Deviation of consensus estimates from actual performance in 3QFY20

(Rsmn)	Actual	Our estimate	Deviation
	3QFY20	3QFY20	(%)
Net sales	40,157	41,943	(4.3)
EBITDA	2,252	2,726	(17.4)
EBITDA (%)	5.6	6.5	(90bps)
Adj. PAT	299	1,021	(70.7)

Source: Nirmal Bang Institutional Equities Research

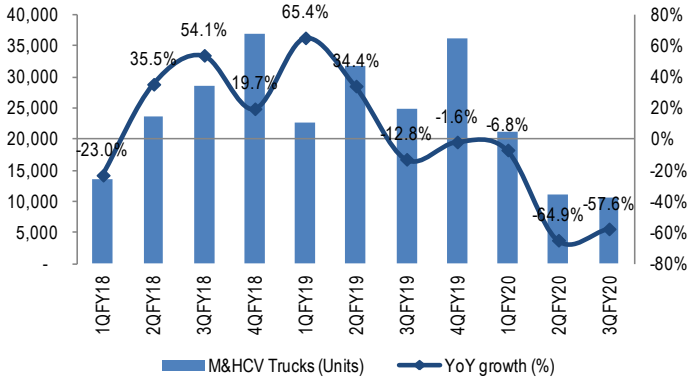
Key takeaways from the conference-call we hosted:

- Demand outlook:** During 3QFY20, industry volume de-grew by ~39% YoY. On YTD basis, industry volume de-grew by ~37% YoY. Domestic demand scenario continues to remain weak on account of reasons such as (1) continued weak customer sentiment which is at all time low (2) Underlying economic growth continues to remain weak and government's measures to revive the economy should be well executed (3) Industry specific issues – except for road construction, other segments of infra continue to remain weak. Management expects 1HFY21 to continue to witness de-growth as the industry is expected see economic recovery led growth only from 3QFY21 onwards. Demand for Passenger Bus, ITD and LCVs have been moderately weak. Management, however, believes that CV industry has bottomed out and will see some recovery from FY21 onwards. AL is targeting export growth over 20% in FY21 on the back of tender wins in African & Sri Lankan market and demand revival in Bangladesh. AL is using this slowdown as an opportunity to implement some structural measures, including cost reduction, focus on productivity and cash flows, and new product development, which management believes will make the company more resilient.
- Volume & market share:** Industry volume for M&HCV declined by 39% YoY to 53,761 units in 3QFY20, while the company's volume declined by ~42% YoY. The company's market share in the M&HCV segment declined by 20bps to 30.2% in 3QFY20. YTD FY20, the company's market share has declined by 60bps to 31.9% compared with 32.5% in YTD FY19. While the company gained market share in 1QFY20, its focus on inventory management in 2Q and 3Q resulted in some market share loss. Also, some market share loss during the quarter was because the company walked away from some deals where it would have lost money, as competition was selling at price lower than variable costs.

- Margins & cost reduction program:** AL's margin declined sharply during the quarter mainly due to reduction in inventory. The company focused on reducing its BS-IV inventory during the quarter, which led to additional overheads being absorbed to the tune of Rs2,500-2600mn (i.e. 6% of revenue for the quarter). Adverse product mix and higher discounts also marginally affected the margins during the quarter. Benign commodity prices and cost reduction efforts partially offset the negative impact on margins. Employee cost was lower on account of VRS scheme announced during the previous quarter (sustainable) and reversal of YTD bonus provisions during this quarter. Management indicated that the company will achieve cost saving target of ~Rs5,000mn in FY20 on efficient cost management across all the functions and expects further cost savings of about Rs6,000-6,500mn in FY21. Management reaffirmed that its cost savings program 'K54' is sustainable and will structurally bring down the breakeven point for the company.
- New platforms:** The company's new LCV platform 'Phoenix', which was expected to be launched in March'20, will now be delayed due to supply related issues in China (on account of Coronavirus). The company is very confident of market share gains on the back of this new platform. The company will also introduce modular platform across its entire product portfolio from April'20 along with BS-VI, which will allow customers to customize the products as per its utilization and will be an attractive value proposition for customers. New models on modular platform will come with right as well as left hand drive so it can be exported. This will reduce manufacturing complexity and improve productivity, thus making operations more efficient.
- Exports:** The Company is redrawing its exports strategy and has much larger product portfolio to offer to its customers globally. AL expects to win project tenders in African & Sri Lankan markets, which will drive demand in FY21. Bangladesh market, which has been facing slowdown since the last one year, is also expected to see revival in FY21. Management believes that the launch of all the products on modular platform along with left hand drive option from April'20 will lead to higher export growth. AL is targeting export growth of over 20% in FY21.
- BS-VI:** AL is currently running trial production of BS-VI vehicles and is testing and validating BS-VI vehicles. Management stated that BS-IV FES (front end structures) production will continue till Feb'20 and fully built vehicle till Mar'20. BS-VI products will be introduced only from April'20 onwards. The company is working to ensure minimum damage in transition to BS-VI in terms of balancing between demand and inventory management. In 1QFY20 earnings call, the management had stated that cost increase due to BS-VI could range between 15% and 30% but it is more concerned in getting product performance right rather than costs post BS-VI implementation.
- Inventory levels:** Total pipeline (Company+Dealer) inventory reduced from ~13,200 units by the end of Oct'19 to ~6,500 units (3,400 with AL & 3,100 with dealers) as of today. The company scaled up inventory to gain market share in 1QFY20 and focused on rationalising the same during 2Q and 3Q. LCV inventory stood at ~10 days. Management stated that inventory will be almost nil by the end of March'20 as BS-VI vehicles will be introduced only from April'20.
- Discounts:** Industry-wide discounting has been rampant and the average discount per vehicle stood high at ~Rs0.525mn in 3QFY20 and 2QFY20 each as against ~Rs0.35-0.4mn/vehicle in 1QFY20. The company partly compensated the dealers for higher discounts which had some impact on margins.
- Capex:** 9MFY20 capex outflow stood at Rs9,600mn and capex guidance for FY20 stands reduced to ~Rs13,000mn as against Rs18,000mn guidance in last quarter. Majority of the capex is towards modular business program, phoenix project, BS-VI, etc. The company has been delaying some of the capex outflow to better manage the cash and it reduced debt from Rs27,600mn at the end of 2QFY20 to ~Rs20,000mn at the end of 3QFY20. Capex for FY21 will be ~Rs4,000-5,000mn, mainly towards maintenance. There will be some outflow towards capex on Phoenix project and investment in subsidiaries.
- Hinduja Leyland Finance:** AL and Hinduja group together bought 7% stake in the finance arm from Everstone at ~2x trailing book value. Expected book value by the end of FY20 will be ~Rs270bn. The company is seeing increase in delinquencies and some truck repossession happening in 1st time buyer segment but overall profitability of the company has been maintained.
- Other:** Share of revenue from spares stood at 9%, Domestic LCVs at 14%, Domestic trucks at 41%, Domestic buses at 20%, Defence business at 1% and Exports at 9%.

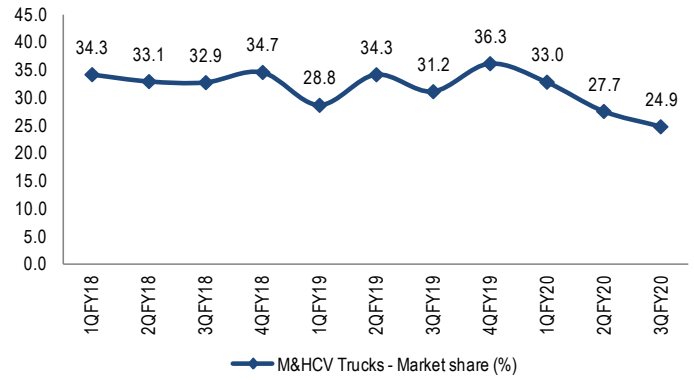
Story in Charts

Exhibit 4: M&HCV Trucks - Domestic volume & YoY growth (%)



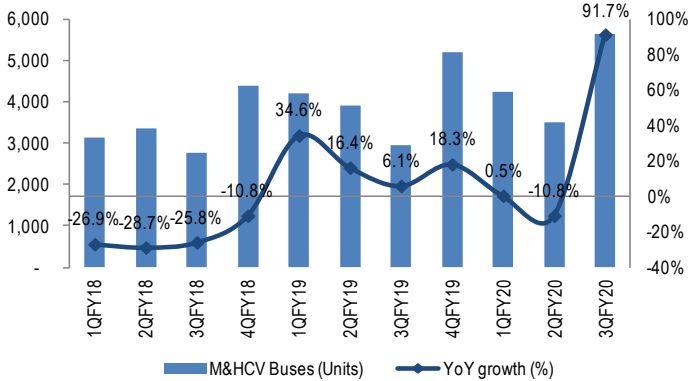
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 5: M&HCV Trucks - Domestic market share (%)



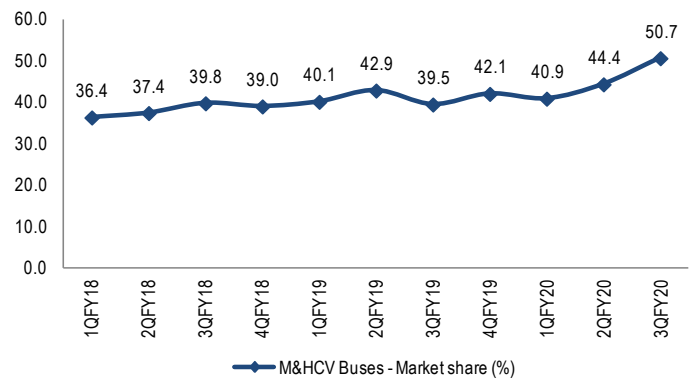
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 6: M&HCV Buses - Domestic volume & YoY growth (%)



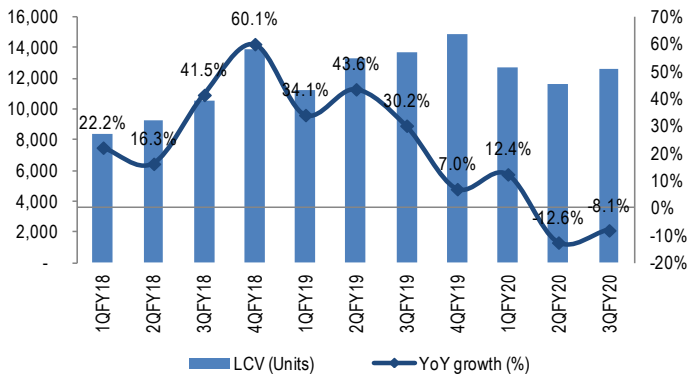
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 7: M&HCV Buses - Domestic market share (%)



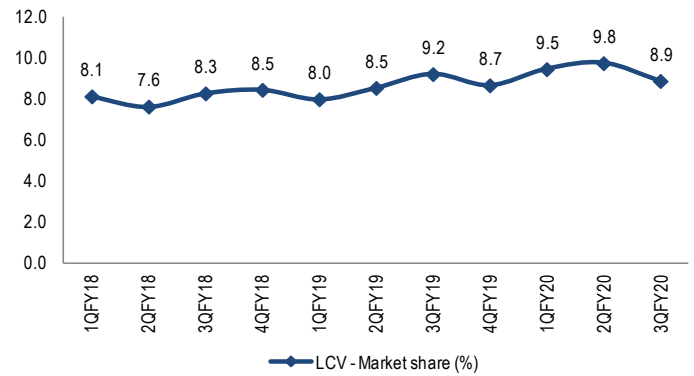
Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 8: LCV - Domestic volume & YoY growth (%)



Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 9: LCV - Domestic market share (%)



Source: SIAM, Nirmal Bang Institutional Equities Research

Exhibit 10: P/E chart



Source: Bloomberg, Nirmal Bang Institutional Equities Research

Financials

Exhibit 11: Income statement

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Net Sales	2,62,479	2,90,550	2,00,408	2,36,466	2,86,476
% Growth	31.1	10.7	(31.0)	18.0	21.1
Raw material	1,86,213	2,06,796	1,41,288	1,65,526	1,99,387
Staff costs	18,119	20,988	17,035	18,917	21,772
Other expenses	30,757	31,409	26,855	30,268	35,523
Total expenses	2,35,089	2,59,192	1,85,177	2,14,711	2,56,683
EBITDA	27,390	31,357	15,231	21,755	29,794
% Growth	24.4	14.5	(51.4)	42.8	37.0
EBITDA margin (%)	10.4	10.8	7.6	9.2	10.4
Other income	1,898	1,099	1,237	1,403	1,646
Interest costs	1,312	704	1,038	838	191
Depreciation	5,546	6,210	7,380	8,359	9,275
Profit before tax (before exceptional items)	22,429	25,543	8,049	13,960	21,973
Exceptional items	122	575	-	-	-
Tax	6,681	5,136	1,610	2,792	4,395
Adj PAT	15,748	20,407	6,439	11,168	17,579
% Growth	35.1	29.6	(68.4)	73.4	57.4
Adj PAT margin (%)	6.0	7.0	3.2	4.7	6.1
EPS (Rs)	5.4	7.0	2.2	3.8	6.0
% Growth	35.1	29.6	(68.4)	73.4	57.4
DPS (Rs)	2.4	3.1	2.5	2.7	3.0
Payout (incl. div. tax) (%)	52.3	52.8	131.1	81.6	57.6

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 13: Balance sheet

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
Share capital	2,927	2,936	2,936	2,936	2,936
Reserves	68,721	80,389	78,299	80,255	87,599
Net worth	71,648	83,324	81,234	83,191	90,534
Total debt	5,157	3,984	11,984	1,984	1,484
Net deferred tax liability	2,984	2,497	2,497	2,497	2,497
Capital employed	79,789	89,806	95,716	87,672	94,516
Gross block	63,121	75,926	89,926	97,926	1,05,926
Depreciation	13,378	19,791	27,171	35,530	44,806
Net block	49,742	56,135	62,755	62,395	61,120
Capital work-in-progress	4,012	6,576	6,576	6,576	6,576
Investments	58,026	26,365	30,365	35,365	40,365
Inventories	17,099	26,847	16,472	20,731	26,685
Debtors	9,805	25,055	17,282	20,391	26,685
Cash	10,044	13,736	16,069	7,457	16,736
Loans & advances & Other current assets	17,132	27,520	28,869	30,285	30,880
Total current assets	54,080	93,158	78,692	78,865	1,00,987
Creditors	46,586	50,179	34,611	40,839	51,016
Other current liabilities & provisions	39,486	42,249	48,060	54,690	63,516
Total current liabilities	86,072	92,428	82,672	95,529	1,14,532
Net current assets	(31,992)	729	(3,980)	(16,664)	(13,546)
Application of funds	79,789	89,806	95,716	87,672	94,516

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 12: Cash flow

Y/E March (Rsmn)	FY18	FY19	FY20E	FY21E	FY22E
OP/(loss) before tax	21,844	25,147	7,851	13,396	20,518
Depreciation & amortization	5,546	6,210	7,380	8,359	9,275
Other income	1,898	1,099	1,237	1,403	1,646
(Inc.)/dec. in working capital	28,341	(29,030)	7,042	4,072	6,160
Direct taxes paid	(4,966)	(5,623)	(1,610)	(2,792)	(4,395)
Other/extra-ordinary items	1,671	359	(1,191)	(1,286)	(1,429)
Cash flow from operations (after E/O)	54,333	(1,837)	20,710	23,152	31,776
Capital expenditure (-)	(7,534)	(15,167)	(14,000)	(8,000)	(8,000)
Net cash after capex	46,799	(17,003)	6,710	15,152	23,776
Other investing activities	(29,238)	31,661	(4,000)	(5,000)	(5,000)
Dividends paid (-)	(7,113)	(9,098)	(7,339)	(7,926)	(8,807)
Inc./(dec.) in total borrowings	(9,605)	(1,877)	6,962	(10,838)	(691)
Others	81	8	-	-	-
Cash from financial activities	(16,637)	(10,966)	(377)	(18,764)	(9,497)
Opening cash balance	9,120	10,044	13,736	16,069	7,457
Closing cash balance	10,044	13,736	16,069	7,457	16,736
Change in cash balance	924	3,692	2,333	(8,612)	9,279

Source: Company, Nirmal Bang Institutional Equities Research

Exhibit 14: Key ratios

Y/E March	FY18	FY19	FY20E	FY21E	FY22E
Per share (Rs)					
EPS	5.4	7.0	2.2	3.8	6.0
EPS Growth (%)	35.1	29.6	(68.4)	73.4	57.4
Cash EPS	7.3	9.1	4.7	6.7	9.1
Book value per share	24.5	28.4	27.7	28.3	30.8
DPS	2.4	3.1	2.5	2.7	3.0
Payout (incl. div. tax) %	52.3	52.8	131.1	81.6	57.6
Valuation (x)					
P/E	15.2	11.7	37.2	21.5	13.6
Cash P/E	11.2	9.0	17.3	12.3	8.9
EV/EBITDA	6.4	6.5	13.5	9.1	6.2
EV/Sales	0.7	0.7	1.0	0.8	0.6
P/BV	3.3	2.9	3.0	2.9	2.6
Dividend yield (%)	3.0	3.8	3.1	3.3	3.7
Return ratios (%)					
RoCE	29.8	29.2	9.5	16.9	23.5
RoE	22.0	24.5	7.9	13.4	19.4
Profitability ratios (%)					
EBITDA margin	10.4	10.8	7.6	9.2	10.4
PAT margin	6.0	7.0	3.2	4.7	6.1
Turnover ratios					
Debtors (days)	14	31	31	31	34
Inventory (days)	24	34	30	32	34
Creditors (days)	65	63	63	63	65
Asset turnover (x)	3	3	2	3	3
Leverage Ratio					
Debt/equity (x)	0.1	0.0	0.1	0.0	0.0

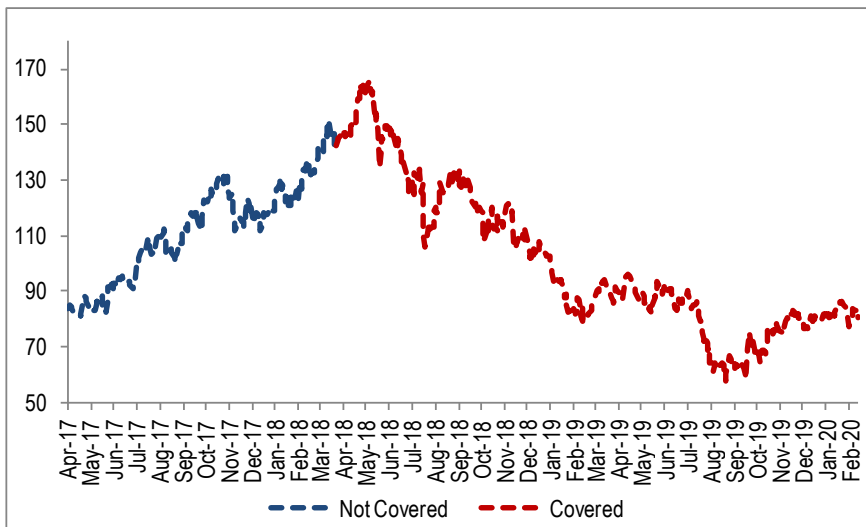
Source: Company, Nirmal Bang Institutional Equities Research

Rating track

Date	Rating	Market price (Rs)	Target price (Rs)
23 March 2018	Buy	142	167
23 May 2018	Buy	141	165
19 July 2018	Buy	111	129
18 September 2018	Buy	127	152
15 February 2019	Buy	84	152
2 August 2019	Buy	69	80
23 September 2019	Buy	75	80
13 November 2019	Buy	79	92
18 February 2020	Buy	82	98

* Coverage shifted to Anish Rankawat wef 2 August 2019

Rating track graph



DISCLOSURES

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Stock Ratings Absolute Returns

BUY > 15%

ACCUMULATE -5% to 15%

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