

Institutional Equity Research

Ashok Leyland

Automobile | India

Update | October 07, 2019

CMP* (Rs)	64
Upside/ (Downside) (%)	73
Bloomberg Ticker	AL IN
Market Cap. (Rs bn)	189
Free Float (%)	49
Shares O/S (mn)	2,936

BUY 

Target Price: Rs111

Multi-Bagger Opportunity with Favourable Risk Reward; Upgrade to BUY

Ashok Leyland (AL) has reported 37% YoY decline in its M&HCV volume in FY20-YTD, while its domestic M&HCV sales declined by 60% YoY in 2QFY20. We believe this is the worst phase of current down-cycle for M&HCV in general and AL in particular. Though we expect similar slowdown to continue for the next 1-2 quarters, the industry would witness sequential improvement steadily. Industry has been undergoing through bottoming out phase of the down-cycle. We expect lower deterioration, going forward though YoY decline would continue till mid-FY21E. Higher axle load norm, NBFC issue, economic slowdown and BS-VI transition would continue impacting till beginning of FY21E (Captured in current price), in our view. We believe that post BS-VI pricing, the industry would take a breather for a quarter, then it would rebound strongly on the back of new investment cycle led by government's tax relief and pent-up demand of previous 2 years. We believe the industry would observe its down-cycle over FY20-FY21 and would strongly rebound in FY22E. Therefore, it is more sensible to consider FY22 for CV industry to judge the right scenario and fair valuation. We downgraded our recommendation on AL to REDUCE due to expected down-cycle, post which it corrected by >31%. Sharp correction in price captures most near-term negatives, while likely up-cycle in FY22E would bring back high earning growth and valuation expansion, which transforms into strong potential upside from the current level. **Therefore, we upgrade our recommendation on the stock to "BUY" from "REDUCE" with an upwardly revised Target Price of Rs111, valuing the stock at 17x FY22E EPS.**

We assume the Company to record its FY22E domestic M&HCV volume 18% lower than the previous peak in FY19 and 7% lower than FY18 (Please refer Exhibit 1), which captures likely negative impact of new freight corridor. Higher-than-expected double-digit decline in FY20 factors in impact of higher axle load norm. Healthy agri output due to excess rainfall, reversal of investment cycle, sizable incremental capex on account of government's tax relief for new investment would bring back cheers for the economy towards the end of 4QFY20. Moreover, improving liquidity situation and government's focus to support automobile industry would start yielding desired outcome in FY21E. Pent-up demand of previous 1.5-2 years would be the single biggest catalyst for strong revival by mid-FY21E. We expect stable market share for AL, while conservatively, we assume its EBIDTA margin of 10.8% for FY22E (110bps lower than the previous peak). Our FY22E EPS estimate is 6% lower to the previous peak despite factoring in lower tax rate.

Outlook & Valuation

Factoring in higher-than-expected volume fall, we reduce our volume estimates by ~18% for FY20E and FY21E. Considering margin contraction on operating leverage and discounts, we reduce our EBIDTA and EPS estimates by 35%/22% and 41%/19% for FY20E/FY21E. As we expect recovery for CV in FY22E, we introduce our estimates for FY22E and roll-over our valuation to FY22E. With 25% discount to AL's historical P/E multiple, we assign 17X P/E (from 14x earlier). **We see AL as a multi-bagger opportunity and at current valuation, risk reward appears to be highly favourable, though near-term issues to remain for at least next 1-2 quarters. In light of expected bottoming out of the industry in foreseeable future and attractive valuation at 9.9x FY22E, we upgrade our recommendation on AL to BUY from REDUCE with a revised Target Price of Rs111 (from Rs62 earlier), valuing it at 17x FY22E EPS. Further valuation expansion with steady improvement in business visibility is on card.**

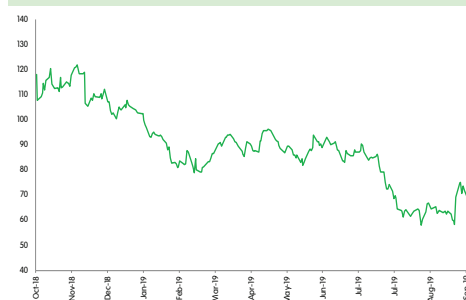
Financial Summary				
(Rs mn)	FY19	FY20E	FY21E	FY22E
Net Sales	290,550	206,447	236,309	307,811
EBITDA	31,357	15,050	20,830	33,247
EBITDA margin (%)	10.8	7.3	8.8	10.8
Adj. Net Profit	19,722	6,365	10,509	19,159
RoE (%)	24.0	7.4	12.0	20.1
RoCE (%)	21.9	7.1	11.2	18.8
PER (x)	9.6	29.7	18.0	9.9
P/BV	2.3	2.3	2.2	2.0
EV/ EBITDA	5.7	12.1	8.9	5.4

Source: Company, RSec Research

Share price (%)	1 mth	3 mth	12 mth
Absolute performance	0.6	(26.1)	(40.5)
Relative to Nifty	(1.0)	(20.3)	(48.3)

Shareholding Pattern (%)	Mar-19	Jun-19
Promoter	51.1	51.1
Public	48.9	48.9

1 Year Stock Price Performance



Note: * CMP as on October 07, 2019

Change of Estimates		
(%)	FY20E	FY21E
Net revenues	(18.1)	(15.4)
EBIDTA	(34.6)	(21.8)
Net Profit	(41.0)	(19.2)
EPS (Rs)	(41.0)	(19.2)

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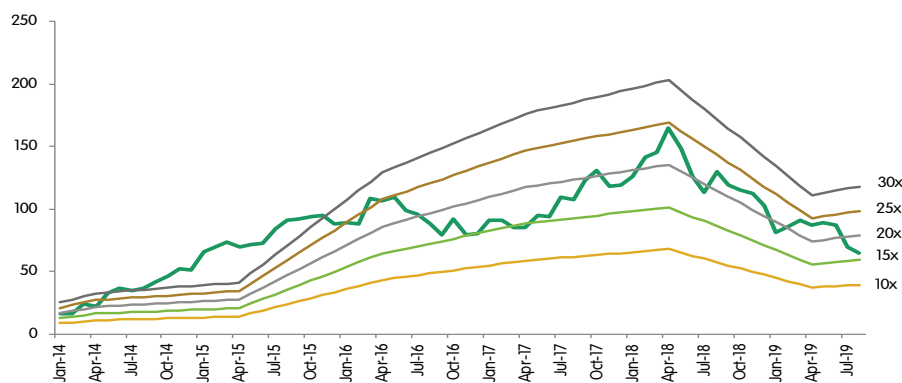
Exhibit 1: Key Parameters for Comparison

Key Data Points	FY16	FY17	FY18	FY19	FY20E	FY21E	FY22E
Volumes (Units)							
M&HCV Domestic	98,809	102,313	116,534	131,936	80,789	83,450	108,897
LCV Domestic	28,512	30,951	42,078	53,129	49,595	42,007	52,195
Total Domestic	127,322	133,264	158,612	185,065	130,384	125,456	161,091
Exports	13,128	11,802	16,240	12,301	9,573	12,444	16,178
Total Volumes	140,450	145,066	174,852	197,366	139,956	137,900	177,269
Revenue (Rs Mn)	189,373	201,401	263,564	290,550	206,447	236,309	307,811
EBIDTA Margins	11.9%	10.9%	11.2%	10.8%	7.3%	8.8%	10.8%
EPS (Rs)	3.92	5.48	5.93	6.9	2.17	3.58	6.5

Source: Company, RSec Research

As highlighted in above table, we assume the Company to record its FY22E domestic M&HCV volume 18% lower than the previous peak in FY19 and 7% lower than FY18, which captures likely negative impact of new freight corridor. Higher-than-expected double-digit decline in FY20 factors in impact of higher axle load norm. Pent-up demand of previous 1.5-2 years would be the single biggest catalyst for strong revival by mid-FY21E. We expect stable market share for AL, while conservatively, we assume its EBIDTA margin of 10.8% (110bps lower than the previous peak). Our FY22E EPS estimate is 6% lower to the previous peak despite factoring in benefit of lower tax rate.

Exhibit 2: 1 year forward P/E Chart



Source: C-Line, Company, RSec Research

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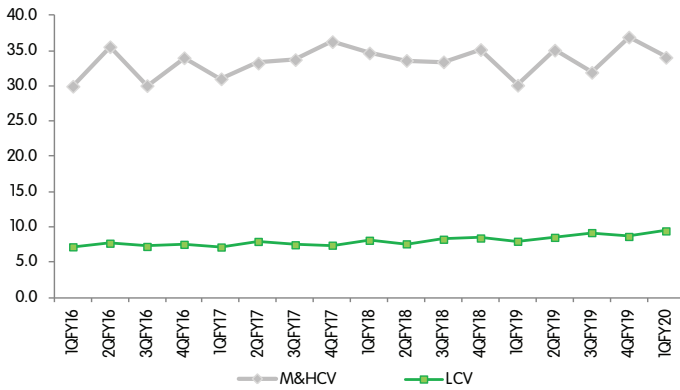
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Exhibit 3: Domestic Market Share Trend (%)



Source: Company, SIAM, RSec Research

Exhibit 4: Segmental Volume Contribution (%)

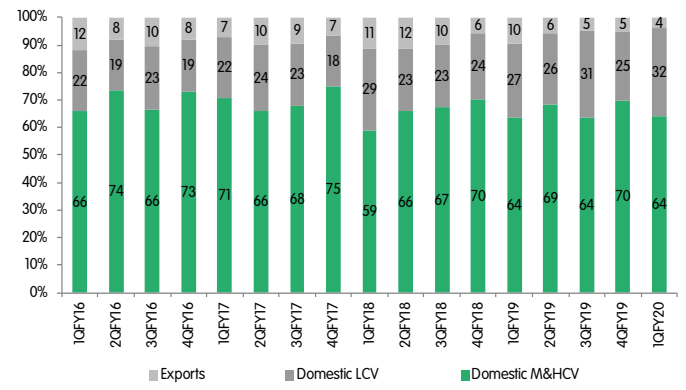
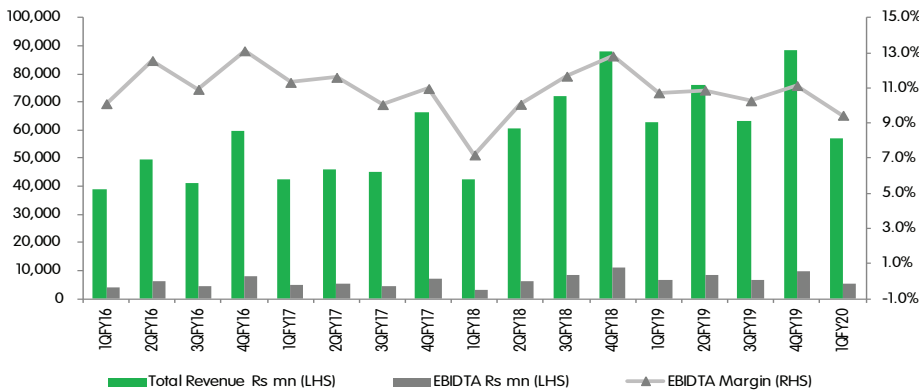


Exhibit 5: Revenue and EBITDA Trend



Source: Company, RSec Research

Exhibit 6: Revised vs. Old Estimates

(Rs mn)	Old		Revised		% change	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	252,131	279,416	206,447	236,309	(18)	(15)
EBITDA	23,018	26,624	15,050	20,830	(35)	(22)
EBITDA margin (%)	9.1	9.5	7.3	8.8		
Net profit	10,790	13,007	6,365	10,509	(41)	(19)
EPS (Rs)	3.7	4.4	2.2	3.6	(41)	(19)

Source: RSec Research

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Profit & Loss Statement

Y/E Mar (Rs mn)	FY19	FY20E	FY21E	FY22E
Net revenue	290,550	206,447	236,309	307,811
Expenditure	259,193	191,397	215,479	274,563
Raw Materials	206,796	145,739	167,307	217,006
Employee Expenses	20,988	20,897	21,942	23,698
Other expenditure	31,410	24,760	26,230	33,859
EBITDA	31,357	15,050	20,830	33,247
Depreciation and amortization expense	6,210	6,898	7,592	8,595
EBIT	25,146	8,151	13,237	24,652
Non-operating income	387	854	1,072	1,145
Interest including finance charges	704	513	298	252
Adjusted pre-tax profit	24,829	8,492	14,012	25,545
Unusual or infrequent items	(138)	201	-	-
Reported pre-tax profit	24,968	8,291	14,012	25,545
Less: taxes	5,136	2,055	3,503	6,386
Reported net profit	19,832	6,236	10,509	19,159
Add: extraordinary items	(138)	201	-	-
Reported net profit for shareholders	19,832	6,236	10,509	19,159
Adjusted net profit for shareholders	19,722	6,365	10,509	19,159
EPS (Rs), based on fully diluted shares	6.7	2.2	3.6	6.5
Fully diluted shares outstanding (mn)	2,936	2,936	2,936	2,936

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Balance Sheet

Y/E Mar (Rs mn)	FY19	FY20E	FY21E	FY22E
Equity capital	2,936	2,936	2,936	2,936
Reserves and surplus	80,389	79,547	82,978	93,290
Total equity	83,324	82,483	85,914	96,225
Deferred tax liability (net)	2,497	2,497	2,497	2,497
Long term borrowings	2,984	1,984	984	484
Short tem borrowings	1,000	1,000	1,000	1,000
Total borrowings	3,984	2,984	1,984	1,484
Current liabilities	92,438	75,777	80,594	93,127
Total liabilities	182,244	163,741	170,989	193,334
Cash and cash equivalents	13,736	10,264	5,559	11,444
Inventory	26,847	16,909	18,128	23,613
Trade receivables	25,057	10,181	11,654	15,180
Other current assets	16,543	18,224	20,077	22,121
Total current assets	82,182	55,578	55,418	72,358
Gross block	84,021	98,397	109,447	121,997
Less: depreciation and amortization	16,900	23,799	31,391	39,986
Add: capital work-in-process	6,576	5,200	7,150	6,600
Total fixed assets	73,697	79,799	85,206	88,611
Investments	26,365	28,365	30,365	32,365
of which, liquid investment	26,365	26,365	26,365	26,365
Total assets	182,244	163,741	170,989	193,334

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Cash Flow Statement

Y/E Mar (Rs mn)	FY19	FY20E	FY21E	FY22E
Operating cashflow				
Pre-tax income	24,968	8,291	14,012	25,545
Add: depreciation and amortization	6,210	6,898	7,592	8,595
Add: interest expense (net)	704	513	298	252
Less: other adjustments	(321)	0	0	0
Less: taxes paid	(5,603)	(2,055)	(3,503)	(6,386)
Add: working capital changes	(29,638)	6,471	272	1,479
Total operating cashflow	(3,680)	20,119	18,670	29,485
Investing cashflow				
Capital expenditure	(7,315)	(13,000)	(13,000)	(12,000)
Investments	30,028	(2,000)	(2,000)	(2,000)
Others	401	-	-	-
Total investing cashflow	23,115	(15,000)	(15,000)	(14,000)
Financing cashflow				
Loans	(6,534)	(1,000)	(1,000)	(500)
Dividend	(8,598)	(7,078)	(7,078)	(8,847)
Interest Payment	(1,029)	(513)	(298)	(252)
Less: Others	40	-	-	-
Total financing cashflow	(16,121)	(8,591)	(8,375)	(9,600)
Net change in cash	3,314	(3,472)	(4,705)	5,885
Opening cash	10,422	13,735	10,263	5,558
Closing cash	13,735	10,263	5,558	11,444

Key Ratios (Y/E Mar)	FY19	FY20E	FY21E	FY22E
Growth Ratios				
Net revenue	9.1	(28.9)	14.5	30.3
EBITDA	5.8	(52.0)	38.4	59.6
Adjusted net profit	20.7	(67.7)	65.1	82.3

Other Ratios (%)				
Effective tax rate	20.6	24.8	25.0	25.0
EBITDA margin	10.8	7.3	8.8	10.8
Adjusted net income margin	6.8	3.1	4.4	6.2
ROaCE	21.9	7.1	11.2	18.8
ROaE	24.0	7.4	12.0	20.1
Total asset turnover ratio (x)	1.6	1.2	1.4	1.7
Inventory days	34	30	28	28
Debtor days	31	18	18	18
Creditor days	63	60	59	58

Per share numbers (Rs)				
Diluted earnings	6.7	2.2	3.6	6.5
Free cash	(3.7)	2.4	1.9	6.0
Book value	28.4	28.1	29.3	32.8

Valuations (x)				
P/E	9.6	29.7	18.0	9.9
EV/EBITDA	5.7	12.1	8.9	5.4
P/B	2.3	2.3	2.2	2.0

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Rating History

Date	Reco	CMP	TP
01-Aug-19	REDUCE	69	62
24-May-19	REDUCE	94	81
05-Apr-19	REDUCE	88	75
15-Feb-19	REDUCE	80	75
08-Jan-19	REDUCE	93	78
18-July-8	BUY	111	125
22-May-18	BUY	141	175

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Rating Guides

Rating	Expected absolute returns (%) over 12 months
BUY	>10%
HOLD	-5% to 10%
REDUCE	>-5%

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