Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

Ashok Leyland Ltd

In-line Q2; margins sustain

Automobiles	Sharekhan code: ASHOKLEY
Reco/View: Buy ↔	CMP: Rs. 173 / Price Target: Rs. 221 ↔

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain a Buy rating on Ashok Leyland Limited (ALL) with an unchanged PT of Rs 221, in expectation of a sustainable double-digit EBITDA margin and steady demand trend.
- Reported EBITDA at Rs 1080 crore in Q2FY24 against an expectation of Rs 1066 crore.
- Management has guided for 8%-10% growth in MHCV industry and over 5%-7% growth in LCV industry in FY24.
- The stock trades at a P/E of 14.9x and EV/EBITDA of 8.2x its FY2026E estimates.

In Q2FY24, broadly ALL (Ashok Leyland) performed in line with the estimates on its continuous focus on registering double-digit EBITDA margin. With a 20.6% q-o-q increase in volumes, ALL reported a 17.7% q-o-q increase in revenue to Rs 9,638 crore (against estimate of Rs 9978 crore) and EBITDA increased by 31.6% q-o-q to Rs 1,080 crore (against estimate of Rs 1066 crore). With a 20 bps gross margin expansion and favourable operating leverage, EBITDA margin expanded by 120 bps q-o-q to 11.2% (against the estimate of 10.7%). This was the consecutive third quarter when ALL reported double-digit EBITDA margin and the management has maintained its guidance of double-digit EBITDA margin for FY24. With this operating performance, APAT has increased by 1.2% q-o-q to Rs 584 crore. Along with the result, ALL also decided to invest Rs 1200 crore in Switch Mobility as equity through its holding company Optare PLC UK. Management is looking for an 8-10% growth in MHCV segment and 5-7% growth in LCV segment in FY24. ALL has been consistently maintaining its market share above 30% in MHCV segment and aiming to sustain market share above 30% via new product launches and network expansion.

Key positives

- ALL has been sustaining EBITDA margin above 10% consecutively for a third quarter in a row.
- Sequentially, employee cost and other expenses contracted 70 bps and 40 bps respectively and drove EBITDA margin expansion.
- EV business enjoys an order book of over 1200 units.

Key negatives

- Average selling prices declined by 2.4% q-o-q on change in product mix.
- LCV segment is facing slower growth than that of MHCV segment.

Management Commentary

- Cost cuts, retention of price hikes and soft commodity cost would help company in registering double-digit EBITDA margin in FY24.
- Bus segment offers healthy growth opportunity in H2FY24 compared to H1FY24.
- The company is continuously looking for a suitable partner for its EV business.

Our Call

Valuation: Maintain Buy with an unchanged PT of Rs.221: After reporting healthy performance in Q2FY24, the management continue to share optimism for CV industry. This was the consecutive third quarter when ALL reported double-digit EBITDA margin and the management has maintained its guidance of double-digit EBITDA margin for FY24. Overall, the management is looking for at least 800 crore of revenue from the defence business in FY24. ALL is strategically looking to expand its market share in north and eastern markets to expand its overall market share in MHCV and LCV space as ALL is relatively weak in north and eastern regions. Further, the company is optimistic on its EV road map via Switch Mobility and has decided to invest Rs 1200 crore in its EV business. The management is targeting to launch an IPO of its financial arm in Q4FY24. Post incorporating Q2Fy24 performance in our earnings estimates and introducing earnings estimates for FY26E, we maintain our Buy on the stock with PT of Rs 221 on steady growth in CVs, robust plans for EV segment and continuous focus on high EBITDA margin.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY22	FY23	FY24E	FY25E	FY26E
Revenues	21,688	36,144	41,685	47,121	53,269
Growth (%)	41.7	66.7	15.3	13.0	13.0
EBIDTA	995	2,931	4,168	4,759	5,433
OPM (%)	4.6	8.1	10.0	10.1	10.2
APAT	31	1,296	2,305	2,934	3,414
Growth (%)			77.9	27.3	16.4
AEPS	0.1	4.4	7.9	10.0	11.6
P/E		39.2	22.0	17.3	14.9
P/BV	6.9	6.0	5.1	4.3	3.6
EV/EBIDTA	48.7	16.0	10.7	9.3	8.2
ROE (%)	0.4	15.4	23.1	24.7	24.5
ROCE (%)	3.0	13.0	20.3	21.8	21.9

Source: Company; Sharekhan estimates

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 14.6

Updated Aug 08, 2023

Low Risk

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

Source: Morningstar

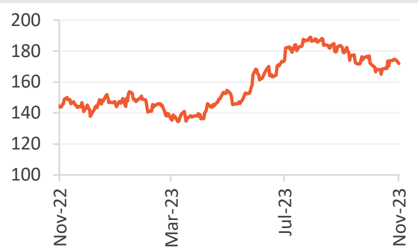
Company details

Market cap:	Rs. 50,785 cr
52-week high/low:	Rs. 191/133
NSE volume: (No of shares)	1.08 cr
BSE code:	500477
NSE code:	ASHOKLEY
Free float: (No of shares)	143.52 cr

Shareholding (%)

Promoters	51.5
FII	20.2
DII	16.5
Others	11.7

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	-2.6	-8.8	14.9	12.6
Relative to Sensex	-1.5	-9.0	9.0	6.0

Sharekhan Research, Bloomberg

Key quarterly highlights

- In Q2FY24, the company achieved a market share of 31.9% in the MHCV segment, with the post-market segment experiencing a 30% y-o-y growth, reaching Rs 655 crore.
- The domestic MHCV segment saw a 10% growth due to favorable macros and replacement demand. Cost-cutting initiatives, a soft raw material cost trend, and regular price hikes contributed to EBITDA margin expansion.
- In the EV segment, Switch Mobility gained traction in the domestic market with orders for 1200 EV buses and over 10,000 enquiries.
- Design work for a European bus is underway. Hinduja Finance, well-funded, plans to launch an IPO in Q4FY24.
- The defence business is expected to deliver at least Rs 800 crore in FY24, with a strong order book and pipeline for FY25.
- The outlook includes continued market share growth through new launches and dealer expansion.
- The bus segment is experiencing strong demand from corporate staff and school buses.
- LCV segment may improve with rising demand from the e-commerce sector.
- The company aims to maintain a double-digit EBITDA margin for FY24.
- The truck industry has been registering healthy demand and trend expected to continue.
- Tippers are growing at twice the rate of the MHCV segment, driven by core sector movement.
- Raw material prices remain soft, and the trend is expected to continue.
- Dealer inventory is under control, with a slight increase in anticipation of healthy festive season sales.
- In Switch Mobility, the company seeks the right partner at the right valuation, planning to invest Rs 1200 crore in FY24.
- Switch India aims to be cash-neutral at the EBITDA level in FY24, while Switch Europe may require funding support. OHM's investment is dependent on requirements.
- ALL believes that the pricing discipline in the industry would be maintained as most of the leading players are focusing on the profit in place of plain-vanilla volume growth.
- The CV industry needs to invest in future in various technologies relevant to the market and hence need to focus on profitability to generate cash and reinvest for growth in future.
- CV industry has gradually moved up from discount-based volume growth business model to a profit-driven volume growth model.
- ALL expects a capex of Rs 600 crore for FY24 compared to Rs 200 crore capex done in H1FY24.
- Tax rate is expected to be ~25% in FY25.

Change in estimates Rs cr

Particulars	Earlier		New		% change		Introduction
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E	FY26E
Volumes (units)	214818	236056	214818	236056	0.0%	0.0%	2,59,398
Revenue	42,246	47,757	41,685	47,121	-1.3%	-1.3%	53,269
EBITDA	3,971	4,776	4,168	4,759	5.0%	-0.3%	5,433
EBITDA margin	9.4%	10.0%	10.0%	10.1%			10.2%
PAT	2,319	2,917	2,305	2,934	-0.6%	0.6%	3,414
EPS	7.9	9.9	7.9	10.0	-0.6%	0.6%	11.6

Source: Company, Sharekhan Research

Results (Standalone) Rs cr

Particulars	Q2FY24	Q2FY23	y-o-y (%)	Q1FY24	QoQ (%)
Net sales	9,638	8,266	16.6	8,189	17.7
Total operating expenses	8,558	7,729	10.7	7,369	16.1
Operating profit	1,080	537	101.0	821	31.6
Depreciation	180	177	2.0	179	0.5
Interest	59	77	(23.8)	70	(16.0)
Other Income	47	20	137.4	51	(7.3)
PBT	888	303	192.7	623	42.6
Tax	302	112	168.8	213	41.7
Reported PAT	561	199	181.5	576	(2.7)
Adjusted PAT	584	191	205.6	577	1.2
Recurring EPS	1.99	0.65	205.6	2.0	1.2

Source: Company, Sharekhan Research

Key ratios (Consolidated)

Particulars	Q2FY24	Q2FY23	y-o-y (bps)	Q1FY24	QoQ (bps)
Gross margin (%)	26.5	22.0	450	26.3	20
EBIDTA margin (%)	11.2	6.5	470	10.0	120
Net profit margin (%)	6.1	2.3	370	7.0	(100)
Effective tax rate (%)	34.0	37.0	(300)	34.2	(20)

Source: Company, Sharekhan Research

Volume analysis (Rs per vehicle)

Particulars	Q2FY24	Q2FY23	y-o-y (%)	Q1FY24	QoQ (%)
Volumes (units)	49,846	45,295	10.0	41,329	20.6
Realisation	19,33,563	18,24,914	6.0	19,81,488	(2.4)
RM/vehicle	14,21,689	14,23,243	(0.1)	14,60,754	(2.7)
Gross Profit/Vehicle	5,11,875	4,01,671	27.4	5,20,734	(1.7)
EBITDA/Vehicle	2,16,625	1,18,631	82.6	1,98,589	9.1
PAT/vehicle	1,17,139	42,188	177.7	1,39,614	(16.1)

Source: Company, Sharekhan Research

Outlook and Valuation

■ Sector view - Expect a steady recovery in CV sales

While CV segment may witness a moderation in growth in FY24 due to high base but we believe that the CV industry would grow by high single digit or low double digit rate in FY24 largely driven by the recovery in replacement demand and rise in demand for bus segment. However the traction would be visible more from Q2FY24 onwards and the industry would follow the trend in infra spending and macro activities.

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

ALL is likely to be the key beneficiary of the expected traction in the domestic CV industry driven by traction in macro economy. Further, ALL has been looking for an improvement in EBITDA margin led by focusing on profit driven market share expansion strategy. ALL will benefit from replacement demand, which is likely to arise due to aging of vehicle population and requirement of cost-effective transportation solutions 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.221

After reporting healthy performance in Q2FY24, the management continue to share optimism for CV industry. This was the consecutive third quarter when ALL reported double-digit EBITDA margin and the management has maintained its guidance of double-digit EBITDA margin for FY24. Overall, the management is looking for at least 800 crore of revenue from the defence business in FY24. ALL is strategically looking to expand its market share in north and eastern markets to expand its overall market share in MHCV and LCV space as ALL is relatively weak in north and eastern regions. Further, the company is optimistic on its EV road map via Switch Mobility and has decided to invest Rs 1200 crore in its EV business. The management is targeting to launch an IPO of its financial arm in Q4FY24. Post incorporating Q2FY24 performance in our earnings estimates and introducing earnings estimates for FY26E, we maintain our Buy on the stock with PT of Rs 221 on steady growth in CVs, robust plans for EV segment and continuous focus on high EBITDA margin.

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 steady upturn in the market due to a faster-than-expected recovery in economic activities. ALL is the second largest MHCV cargo player in the domestic market and enjoys healthy market share in domestic MHCV passenger carrier market. Its market share in MHCV cargo segment stood at 32.3% and in MHCV passenger carrier stood at 28.03% in Fy23. 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). 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 commodity prices continue to rise going forward, can affect the company's profitability.

Additional Data

Key management personnel

Dhiraj Hinduja	Chairman
Shenu Agarwal	MD & CEO
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	34.72%
2	Hinduja Bank Switzerland	4.94%
3	Vanguard Group Inc/The	1.97%
4	Blackrock INC	1.81%
5	HDFC Life Insurance	1.54%
6	Canara Robeco AMC	1.47%
7	Schroders PLC	1.46%
8	ICICI Prudential Life Insurance Co Ltd	1.41%
9	Norges Bank	1.29%
10	Matthews International Capital Mgmt LLC	1.29%

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

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