Sharekhan by BNP PARIBAS

Powered by the Sharekhan 3R Research Philosophy

Stock Update

Result Update

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 14.60

Updated Jun 08, 2023

Low Risk

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

Source: Morningstar

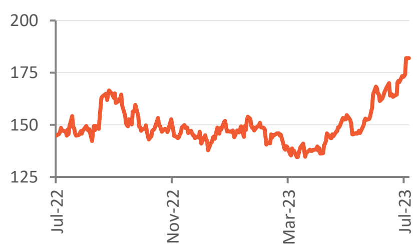
Company details

Market cap:	Rs. 53,427 cr
52-week high/low:	Rs. 183 / 133
NSE volume: (No of shares)	1.01 lakh
BSE code:	500477
NSE code:	ASHOKLEY
Free float: (No of shares)	143.52 cr

Shareholding (%)

Promoters	51.1
FII	16.6
DII	20.8
Others	11.5

Price chart



Price performance

(%)	1m	3m	6m	12m
Absolute	10.2	33.6	21.8	25.6
Relative to Sensex	5.2	21.8	10.8	1.5

Sharekhan Research, Bloomberg

Ashok Leyland Ltd

All eyes on the margins

Automobiles		Sharekhan code: ASHOKLEY		
Reco/View: **Buy**	↔	CMP: **Rs. 182**	Price Target: **Rs. 221**	↑

↑ Upgrade ↔ Maintain ↓ Downgrade

Summary

- We retain our Buy rating on Ashok Leyland Limited (ALL), with a revised target price of Rs. 221 on expectation of an 11% volume CAGR along with 190-bps expansion in EBITDA margin in the next two years, recovery in the bus segment, and RM cost tailwind.
- The company reported double-digit margin for the second consecutive quarter, as OPM exceeded estimates by 150 bps to 10.0% in Q1FY2024.
- Management has guided for 8-10% growth in the MHCV industry and over 5-6% growth in the LCV industry in FY2024.
- The stock is trading at a P/E of 18.3x and EV/EBITDA of 10.1 its FY2025E estimates.

Ashok Leyland Limited (ALL) reported higher-than-expected Q1FY2024 operating performance, on account of greater-than-expected gross margin expansion Revenue came in line with estimates; however, EBITDA margin exceeded estimates by 150 bps. Along with that, low tax provisioning resulted in strong bottom-line performance. This was consecutively the second quarter when ALL reported double-digit EBITDA margin, given the company has been guiding for a double-digit margin in FY2024. Revenue increased by 13.4% y-o-y to Rs. 8,189 crore (vs. expectation of Rs. 8,169 crore), led by a 4.2% y-o-y increase in volumes and 8.8% y-o-y rise in ASPs. EBITDA increased by 156.3 y-o-y to Rs. 821 crore (vs. expectation of Rs. 696 crore). EBITDA margin expanded by 560 bps y-o-y to 10% (vs. expectation of 8.5*%) on account of a 560-bps gross margin expansion. With this operating performance, APAT increased by 948.3% y-o-y to Rs. 577 crore (vs. expectation of Rs. 340 crore). ALL has been consistently maintaining its market share above 30% in the MHCV segment for the last six quarters and is aiming for a market share of 35% in the MHCV segment in the long term on improvement in its presence in the north and eastern regions. Further, management continues to hold its guidance of double-digit EBITDA margin in FY2024.

Key positives

- In Q1FY2024, ALL registered a 60-bps y-o-y expansion in its market share in the MHCV truck segment to 31.7% and a 790 bps y-o-y expansion in the bus segment to 28.1% on support of network expansion.
- Despite the 30.8% q-o-q decline in volumes, EBITDA margin contracted by mere 100 bps q-o-q to 10% on healthy gross margin expansion. Gross margin expanded by 190 bps q-o-q and 560 bps y-o-y.
- Effective tax rate stood low in Q1FY2024 at 7.3% due to the recognition of defer tax benefit of Rs. 167.5 crore.

Key negatives

- ASPS were up by mere 1.7% q-o-q and EBITDA per vehicle declined by 7.1% q-o-q due to lack of operating leverage.
- Interest cost increased marginally from Rs. 63 crore in Q4FY2023 to Rs. 70 crore in Q1FY2024.
- Net debt in Q1FY2024 stood at Rs. 1,464 crore compared to net cash of Rs. 243 crore in FY2023 due to operational working capital movement.

Management Commentary

- ALL plans to launch a product in the 0-2t LCV segment at an appropriate time.
- Cost cuttings, retention of price hikes, and soft commodity cost would help the company in registering double-digit EBITDA margin in FY2024.
- The company is aspiring for a 15% EBIDTA margin and 35% market share in the MHCV segment in the medium to long term.

Our Call

Valuation – Maintain Buy with a revised PT of Rs. 221: ALL reported strong operating performance in Q1FY2024 as despite inline topline performance, EBITDA margin came in above estimates by 150 bps. Management has been targeting double-digit EBITDA margin in FY2024, and this was consecutively the second quarter when ALL reported a strong double-digit margin. ALL is strategically looking to expand its market share in the north and eastern markets to expand its overall market share in the MHCV and LCV space, as ALL is relatively weak in north and eastern regions. Further, the company is optimistic about its EV road map via Switch Mobility. We have incorporated Q1FY2024 performance and have increased our earnings estimates by 18.5% and 16.9% for FY2024 and FY2025, respectively, mainly on aligning our EBITDA margin expectations in line with management's guidance, given this was the second consecutive quarter when ALL reported double-digit EBITDA margin. We maintain our Buy rating on the stock with a revised target price (TP) of Rs. 221 on expectation of an 11% volume CAGR along with a 190-bps expansion in EBITDA margin in the next two years, recovery in the bus segment, and raw-material (RM) cost tailwind.

Key Risks

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

Valuation (Standalone) Rs cr

Particulars	FY21	FY22	FY23P	FY24E	FY25E
Revenues	15,301	21,688	36,144	42,246	47,757
Growth (%)	.	41.7	66.7	16.9	13.0
EBIDTA	535	995	2,931	3,971	4,776
OPM (%)	3.5	4.6	8.1	9.4	10.0
APAT	(302)	31	1,296	2,319	2,917
Growth (%)	-176.3	-110.3	4079.0	79.0	25.8
AEPS	(1)	0.1	4.4	7.9	9.9
P/E	(177.1)	1,723.4	41.2	23.0	18.3
P/BV	7.7	7.3	6.3	5.4	4.5
EV/EBIDTA	99.6	51.4	16.9	12.2	10.1
ROE (%)	-4.3	0.4	15.4	23.2	24.7
ROCE (%)	-0.7	3.0	13.0	20.1	21.7

Source: Company; Sharekhan estimates

MHCV segment: Looking for a 35% market share in the medium term

- While ALL has maintained its market share above 30% in the MHCV segment for the past six quarters, it has been aiming for a 35% kind of market share in the long term.
- In FY2023, the company gained market share in the MHCV segment across the regions. Historically, ALL has been relatively weak in north and east regions as the its market share in the north and east regions is substantially lower than that of its market share in other regions. Hence, the company is strategically looking to (1) defend its market positioning in southern regions, (2) expand in west and central regions, and (3) increase penetration in north and eastern regions.
- Given ALL's market share in north and eastern markets is relatively low, the company is focussing on the northern and eastern markets via expanding its dealership network and launching suitable products to expand its market share.
- ALL's market share in the northern and eastern regions stood around 25% compared to 30% plus market share at pan-India level in the MHCV segment. Management believes market share expansion in the northern and eastern regions towards 30% level would help it in registering overall 35% market share in the long term.

CV industry is shifting from discounts to profitability

- ALL believes pricing discipline in the industry would be maintained as most of the leading players are focusing on profit in place of plain vanilla volume growth.
- In future, the CV industry needs to invest in various technologies relevant to the market and, hence, needs to focus on profitability to generate cash and reinvest for future growth.
- The CV industry has gradually moved up from a discount-based volume growth business model to a profit-driven volume growth model.
- ALL increased average prices by 2% in Q1FY2024.
- Discount levels in the industry have come down by 10 -15% in the last one year.

Defense segment is expected to perform well in the next two years

- Over the period, the company has developed a variety of products for the defense segment.
- The defense segment has not contributed much in FY2023, but management expects that ALL would perform well in the defense segment in FY2024 and FY2025.
- The company recently won an order worth Rs. 800 crore from the defense sector and expects to participate in more tenders in the coming period.

Others

- The company is planning to launch LCV products in the 0-2t segment; however, it has yet to fix the product launch timeline.
- ALL has planned to support Switch Mobility by Rs. 1,200 crore in FY2024. It has given temporary loan of Rs. 200 crore in Q1FY2024. It has been continuously looking for a strategic investor for Switch Mobility.
- The spare part business registered 34% y-o-y growth in Q1FY2024.

Outlook: Guided for double-digit EBITDA margin in FY2024

- Volume performance in Q1FY2024 was impacted due to prebuying before implementation of BSVI phase II norms from April 2023. However, management believes the MHCV segment will witness improvement in volumes from Q2FY2024.
- Backed by improvement in infra spending and favourable macro trends, management expects the MHCV segment to grow by 8-10% and the LCV segment to increase by 5-6% in FY2024.
- The commodity cost trend is expected to be soft in the coming period.
- With retention of price hikes and material cost control, management holds its double-digit EBITDA margin target for FY2024.
- Continuous focus on value engineering, regular price hikes in the past, retention of price hikes, and value-added propositions to customers would help it in registering double-digit EBITDA margin in FY2024.
- With continued launches and network expansion, management is aiming for a 35% market share in the MHCV industry and over 15% EBITDA margin in the long term.

Results (Standalone) Rs cr

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Net sales	8,189	7,223	13.4	11,626	(29.6)
Total operating expenses	7,369	6,903	6.8	10,350	(28.8)
Operating profit	821	320	156.3	1,276	(35.7)
Depreciation	179	182	(1.7)	184	(2.4)
Interest	70	69	1.4	63	11.3
Other Income	51	26	99.6	39	31.5
PBT	623	95	558.0	1,068	(41.7)
Tax	213	40	438.4	373	(42.9)
Reported PAT	576	68	747.1	751	(23.3)
Adjusted PAT	577	55	948.3	695	(17.0)
Recurring EPS	1.97	0.19	948.3	2.4	(17.0)

Source: Company; Sharekhan Research

Key Ratios (Standalone)

Particulars	Q1FY24	Q1FY23	YoY (bps)	Q4FY23	QoQ (bps)
Gross margin (%)	26.3	20.7	560	24.4	190
EBIDTA margin (%)	10.0	4.4	560	11.0	(100)
Net profit margin (%)	7.0	0.8	630	6.0	110
Effective tax rate (%)	34.2	41.8	(760)	34.9	(70)

Source: Company; Sharekhan Research

Volume Analysis (Rs per vehicle)

Particulars	Q1FY24	Q1FY23	YoY (%)	Q4FY23	QoQ (%)
Volumes (units)	41,329	39,651	4.2	59,697	(30.8)
Realisation	19,81,488	18,21,606	8.8	19,47,446	1.7
RM/vehicle	14,60,754	14,44,617	1.1	14,72,213	(0.8)
Gross Profit/Vehicle	5,20,734	3,76,989	38.1	4,75,233	9.6
EBITDA/Vehicle	1,98,589	80,775	145.9	2,13,703	(7.1)
PAT/vehicle	1,39,614	13,881	905.8	1,16,418	19.9

Source: Company; Sharekhan Research

Outlook and Valuation

■ **Sector Outlook – Expect a steady recovery in CV sales:** While the CV segment may witness growth moderation in FY2024 due to high base, we believe the CV industry would grow in high single digits or at a low double-digit rate in FY2024, largely driven by recovery in replacement demand and rise in demand for the bus segment. However, traction would be visible more from Q2FY2024 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 the macro economy. Further, ALL has been looking for improvement in EBITDA margin, led by focus 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 a revised PT of Rs. 221:** ALL reported strong operating performance in Q1FY2024 as despite inline topline performance, EBITDA margin came in above estimates by 150 bps. Management has been targeting double-digit EBITDA margin in FY2024, and this was consecutively the second quarter when ALL reported a strong double-digit margin. ALL has maintained its guidance of double-digit EBITDA margin for FY2024. ALL is strategically looking to expand its market share in the north and eastern markets to expand its overall market share in the MHCV and LCV space, as ALL is relatively weak in north and eastern regions. Further, the company is optimistic about its EV road map via Switch Mobility. We have incorporated Q1FY2024 performance and have increased our earnings estimates by 18.5% and 16.9% for FY2024 and FY2025, respectively, mainly on aligning our EBITDA margin expectations in line with management's guidance, given this was the second consecutive quarter when ALL reported double-digit EBITDA margin. We maintain our Buy rating on the stock with a revised TP of Rs. 221 on expectation of an 11% volume CAGR along with a 190-bps expansion in EBITDA margin in the next two years, recovery in the bus segment, and RM cost tailwind.

Change in estimates Rs cr

Particulars	Earlier		New		% change	
	FY24E	FY25E	FY24E	FY25E	FY24E	FY25E
Volumes (units)	214818	236056	214818	236056	0.0%	0.0%
Revenue	41,039	45,557	42,246	47,757	2.9%	4.8%
EBITDA	3,488	4,214	3,971	4,776	13.8%	13.3%
EBITDA margin	8.5%	9.3%	9.4%	10.0%		
PAT	1,957	2,495	2,319	2,917	18.5%	16.9%
EPS	6.7	8.5	7.9	9.9	18.5%	16.9%

Source: Company; Sharekhan Research

One-year forward EV/EBITDA (x) band

Source: Sharekhan Research

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 a 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 the domestic MHCV passenger carrier market. The company's market share in the MHCV cargo segment stood at 32.3% and in MHCV passenger carrier stood at 28.03% in FY2023. We are positive on ALL due to 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 the domestic market's share would affect margins. Moreover, going ahead, any increase in commodity prices 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 Website

Top 10 shareholders

Sr. No.	Holder Name	Holding (%)
1	Hinduja Automotive Ltd	34.72
2	Citigroup Inc	12.02
3	Hinduja Bank Switzerland	4.94
4	Mirae Asset Global Investments Co Ltd	1.94
5	ICICI Prudential Life Insurance Co Ltd	1.82
6	ICICI Prudential Asset Management Co Ltd/India	1.66
7	HDFC Life Insurance Co Ltd	1.56
8	Vanguard Group Inc/The	1.55
9	Schroders PLC	1.46
10	SBI Funds Management Ltd	1.42

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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