

Buy

## Ashok Leyland

Industry: Auto and Auto Components

LKP  
Since 1948

## LCV merger, better product mix drive margins, guides for muted FY 21

## Weak volumes and realizations impact topline

Ashok Leyland (ALL) reported 11.1% yoy and 16.9% qoq fall in the topline. Volume dip was at 6% yoy and the realizations were down by about 5%. The company's market share dipped by 1% yoy close to ~32% in the Trucks segment and ~40% in Buses segment. Margins came in at 10.3% better than market estimates as input costs weakened in December and product mix improvement was seen in the form of higher sale of high margin products like tippers & MAVs. Despite higher discounts, the company took price hike in November. RM to sales came in at 70.1% down from 71.4% yoy and 72.7% qoq. Employee costs as a % of sales however went up to 7.9% from 6.9% yoy, while other expenses moved up to 11.7% from 10.6% on higher discounts yoy. Below the operating level, other income was lower both yoy and qoq, while depreciation expenses remained firm growing by 19% yoy. In this quarter the LCV business got totally merged in AL, due to which margins as well as overall profitability got boosted. Tax rates came down to 21% to LCV merger (840 mn tax benefit). The dip in net profits was therefore limited to 13.6% yoy at Rs3.8bn.

## Long term triggers remain intact despite short term challenges

Ashok Leyland (AL)'s volumes de-grew by 6% yoy on 1). High base 2). NBFC crisis & 3). Axle load norms. This is considered to be temporary as the macro drivers remain intact. There has been no slowdown in freight rates growth, while BS VI norms implementation would trigger demand from Q2 FY20 onwards according to management. Post FY20, management expects demand for trucks to be muted, but at the same time, if scrappage policy gets implemented as per expectations, then a multi-year CV demand will be triggered. Positive economic outlook shall lead to a strong CV growth particularly on the tipper and the haulage side of the business on strong infrastructure development. We expect MHCV trucks to grow at 14%/10%/5% in FY 19E/20E/21E respectively.

## LCV merger to add steam to financials

AL merged their LCV business in Q3 (9% of topline, even higher than buses business at 7%) which benefited the company's margins and promises to add more going forward. AL has about 40-45% exposure to the LCV industry, out of which the ICV business has increased its market share from 10% to 22% in last 10 years. The company has a successful product 'Dost' and its variants giving a tough time to its competitors. AL also has Guru, Mitra and Partner models in LCV business which are quite successful. AL now plans to plug loopholes by launching a 3.5-6T LCV-Phoenix. LCV merger has led to higher tax benefits in the quarter (21% tax rate in Q3) and is expected to add operating synergies and provide cost benefits to the company. At a capex of Rs 35cr, management plans to double their LCV capacity from current 75K p.a. in a year's time.

## Margin tailwinds gather

Despite strong competition and amidst discounting across the industry, AL has been increasing prices at the expense of a slight market share dip. Falling input costs, price hike taken in November and LCV merger led to arrest of a steep margin fall. Going forward, with easing of input costs, stringent cost cutting initiatives, Modular program (150 bps benefit expected in FY20-21), product mix in favor of tippers, haulage & MHCV and LCV merger and price hikes trend in every quarter, we see margin escalation every year. Fall in inventory levels from ~12,700 units by Q3 end to ~9000 units in January will ease up overall costs.

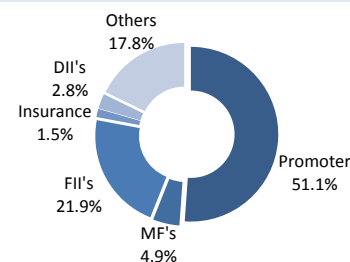
## Stock Data

|                         |                   |
|-------------------------|-------------------|
| Rating                  | Buy               |
| Current Market Price(₹) | 79                |
| 12 M Price Target (₹)   | 99                |
| Potential upside (%)    | 25                |
| FV (₹)                  | 1                 |
| Market Cap Full (₹ bn)  | 234               |
| 52-Week Range (₹)       | 78 / 168          |
| BSE / NSE Code          | 500477 / ASHOKLEY |
| Reuters / Bloomberg     | ASOK.BO / AL.IN   |

## What's Changed

|                           |                   |
|---------------------------|-------------------|
| 12 month Price Target (₹) | From 125 to 99    |
| FY2019E EPS (₹)           | From 6.73 to 6.57 |
| FY2020E EPS (₹)           | From 8.33 to 7.92 |
| FY2021E EPS (₹)           | 8.97              |

## Shareholding Pattern (December 2018)



| YE Mar             | FY18  | FY19E | FY20E | FY21E |
|--------------------|-------|-------|-------|-------|
| Revenues(₹ bn)     | 262   | 306   | 354   | 388   |
| EBITDA (%)         | 10.4% | 10.2% | 10.8% | 11.3% |
| PAT (%)            | 6.0%  | 6.1%  | 6.4%  | 6.6%  |
| Adj EPS (₹)        | 5.53  | 6.57  | 7.92  | 8.97  |
| EPS growth (%)     | 16.5% | 18.7% | 20.5% | 13.4% |
| P/E (x)            | 14.5  | 12.2  | 10.1  | 8.9   |
| P/B (x)            | 3.2   | 2.5   | 2.1   | 2.1   |
| EV/EBITDA (x)      | 8.1   | 7.0   | 5.6   | 5.0   |
| ROCE (%)           | 26.2% | 24.3% | 26.2% | 30.7% |
| ROE (%)            | 21.8% | 20.7% | 20.9% | 23.7% |
| Dividend yield (%) | 1.4%  | 1.7%  | 2.1%  | 2.4%  |

## Relative Price Performance



| All fig in ₹ mn   | Q3 FY19 | Q2 FY19 | % qoq    | Q3 FY18 | % yoy    |
|-------------------|---------|---------|----------|---------|----------|
| Total income      | 63,252  | 76,080  | -16.9%   | 71,132  | -11.1%   |
| Raw Material Cost | 44,357  | 55,287  | -19.8%   | 50,818  | -12.7%   |
| Staff Cost        | 4,930   | 5,174   | -4.7%    | 4,918   | 0.2%     |
| Other Expenses    | 7,398   | 7,398   | 0.0%     | 7,518   | -1.6%    |
| Total Expenses    | 56,756  | 67,859  | -16.4%   | 63,254  | -10.3%   |
| EBITDA            | 6,496   | 8,221   | -21.0%   | 7,877   | -17.5%   |
| EBITDA margin (%) | 10.3%   | 10.8%   | (50 bps) | 11.1%   | (80 bps) |
| Other Income      | 208     | 281     | -26.0%   | 380     | -45.2%   |
| Depreciation      | 1,607   | 1,402   | 14.6%    | 1,350   | 19.0%    |
| Interest          | 192     | 174     | 10.4%    | 335     | -42.8%   |
| PBT               | 4,906   | 6,926   | -29.2%   | 6,572   | -25.3%   |
| Total tax         | 1,027   | 2,010   | N/A      | 2,080   | N/A      |
| Adjusted PAT      | 3,879   | 4,916   | -21.1%   | 4,492   | -13.6%   |
| Exceptional items | (70)    | 159     | N/A      | -       | NA       |
| Reported PAT      | 3,809   | 4,757   | -19.9%   | 4,492   | -15.2%   |

### Outlook and valuation

Despite street concerns regarding CV cycle turning negative, we believe that long term drivers remain intact. In short term, till Q2 of FY20, on high base of H1 FY19, there will be a flat to negative growth in trucks business. However, from Q2 onwards, for the next three quarters, we may see buoyancy coming back in the form of BS VI pre-buying. Post which flattish growth is expected in FY21 provided scrappage policy does not get implemented by April 20. In the event of its happening, we may see a strong demand in replacement segment. On the margin front, softening on price hikes, LCV merger, Modular program, cost cutting initiatives, price hikes etc will drive margins. Reduction in inventories and limited capex growth (₹ 1000 cr in FY20 v/s ~800-900 cr in FY19) will lead to ROE improvement. With strong prospects for LCV business and increased focus from management, we remain sanguine on the stock. We maintain BUY with a reduced target of ₹ 99.

| Per unit parameters         | Q3 FY19   | Q2 FY19   | Q1 FY19   | Q4 FY18   | Q3 FY18   | Q2 FY18   | Q1 FY18   | Q4 FY17   |
|-----------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Avg Price Realisation (net) | 14,48,982 | 14,68,410 | 14,91,177 | 15,07,094 | 15,29,416 | 14,79,398 | 14,94,175 | 13,98,569 |
| Material cost / unit (₹)    | 10,16,132 | 10,67,096 | 10,38,121 | 10,83,361 | 10,92,653 | 10,53,819 | 10,37,455 | 10,06,013 |
| Staff cost / unit (₹)       | 1,14,556  | 99,855    | 1,17,619  | 78,154    | 1,05,743  | 1,18,046  | 1,54,302  | 87,031    |
| Other Expn / unit (₹)       | 1,69,477  | 1,42,792  | 1,80,951  | 1,68,161  | 1,61,646  | 1,57,856  | 1,94,482  | 1,51,271  |
| Total Expn / unit (₹)       | 13,00,165 | 13,09,743 | 13,36,692 | 13,29,676 | 13,60,042 | 13,29,721 | 13,86,239 | 12,44,315 |
| EBITDA per unit             | 1,48,817  | 1,58,667  | 1,54,485  | 1,77,417  | 1,69,374  | 1,49,677  | 1,07,937  | 1,54,254  |
| PAT per unit                | 88,853    | 94,887    | 93,287    | 1,13,625  | 96,577    | 82,419    | 44,616    | 1,32,179  |

**Financials**
**Income statement**

| YE Mar (₹.mn)       | FY 18         | FY 19E        | FY20E         | FY21E         |
|---------------------|---------------|---------------|---------------|---------------|
| Total Revenues      | 2,62,479      | 3,06,134      | 3,54,299      | 3,87,581      |
| Raw Material Cost   | 1,86,212      | 2,17,049      | 2,49,781      | 2,71,306      |
| Employee Cost       | 18,119        | 22,654        | 26,572        | 29,844        |
| Other Exp           | 30,757        | 35,205        | 39,682        | 42,634        |
| <b>EBITDA</b>       | <b>27,391</b> | <b>31,226</b> | <b>38,264</b> | <b>43,797</b> |
| EBITDA Margin(%)    | 10.4%         | 10.2%         | 10.8%         | 11.3%         |
| Other income        | 1898          | 1100          | 1200          | 1100          |
| Depreciation        | 5,546         | 6,271         | 7,034         | 7,664         |
| Interest            | 1312          | 800           | 700           | 750           |
| <b>PBT</b>          | <b>22,430</b> | <b>25,255</b> | <b>31,730</b> | <b>36,482</b> |
| PBT Margin(%)       | 8.5%          | 8.2%          | 9.0%          | 9.4%          |
| Tax                 | 6,681         | 6,566         | 9,202         | 10,945        |
| <b>Adj PAT</b>      | <b>15,749</b> | <b>18,689</b> | <b>22,528</b> | <b>25,538</b> |
| Adj PAT Margins (%) | 6.0%          | 6.1%          | 6.4%          | 6.6%          |
| Exceptional items   | -121.1        | 0.0           | 0.0           | 1.0           |
| <b>PAT</b>          | <b>15,628</b> | <b>18,689</b> | <b>22,528</b> | <b>25,537</b> |
| PAT Margin (%)      | 6.0%          | 6.1%          | 6.4%          | 6.6%          |

**Key Ratios**

| YE Mar                          | FY 18        | FY 19E       | FY20E        | FY21E        |
|---------------------------------|--------------|--------------|--------------|--------------|
| <b>Per Share Data (₹)</b>       |              |              |              |              |
| Adj. EPS                        | 5.53         | 6.57         | 7.92         | 8.97         |
| CEPS                            | 7.5          | 8.8          | 10.4         | 11.7         |
| BVPS                            | 25.2         | 31.7         | 37.9         | 37.9         |
| DPS                             | 1.1          | 1.4          | 1.7          | 1.9          |
| <b>Growth Ratios(%)</b>         |              |              |              |              |
| Total revenues                  | 31.1%        | 16.6%        | 15.7%        | 9.4%         |
| EBITDA                          | 24.4%        | 14.0%        | 22.5%        | 14.5%        |
| PAT                             | 16.5%        | 18.7%        | 20.5%        | 13.4%        |
| EPS Growth                      | 16.5%        | 18.7%        | 20.5%        | 13.4%        |
| <b>Valuation Ratios (x)</b>     |              |              |              |              |
| PE                              | 14.5         | 12.2         | 10.1         | 8.9          |
| P/CEPS                          | 10.7         | 9.1          | 7.7          | 6.9          |
| P/BV                            | 3.2          | 2.5          | 2.1          | 2.1          |
| EV/Sales                        | 0.8          | 0.7          | 0.6          | 0.6          |
| EV/EBITDA                       | 8.1          | 7.0          | 5.6          | 5.0          |
| <b>Operating Ratios (Days)</b>  |              |              |              |              |
| Inventory days                  | 23.8         | 32.0         | 36.0         | 38.0         |
| Receivable Days                 | 13.6         | 16.0         | 18.0         | 20.0         |
| Payables day                    | 64.8         | 68.0         | 72.0         | 76.0         |
| <b>Profitability Ratios (%)</b> |              |              |              |              |
| <b>ROCE</b>                     | <b>26.2%</b> | <b>24.3%</b> | <b>26.2%</b> | <b>30.7%</b> |
| ROE                             | 21.8%        | 20.7%        | 20.9%        | 23.7%        |
| Dividend payout                 | 20.8%        | 21.0%        | 21.0%        | 21.0%        |
| Dividend yield                  | 1.4%         | 1.7%         | 2.1%         | 2.4%         |

**Balance sheet**

| YE Mar (₹ mn)                       | FY 18           | FY 19E          | FY 20E          | FY 21E          |
|-------------------------------------|-----------------|-----------------|-----------------|-----------------|
| <b>EQUITY AND LIABILITIES</b>       |                 |                 |                 |                 |
| <b>Shareholder's funds</b>          |                 |                 |                 |                 |
| Share capital                       | 7,536           | 7,536           | 7,536           | 7,536           |
| Reserves and surplus                | 64,892          | 79,656          | 97,454          | 97,454          |
| <b>Total networth</b>               | <b>71,648</b>   | <b>90,119</b>   | <b>1,07,917</b> | <b>1,07,917</b> |
| <b>Non current liabilities</b>      |                 |                 |                 |                 |
| Long term borrowings & provisions   | 6,707           | 7,907           | 6,907           | 5,607           |
| Deferred tax liabilities            | 2984            | 2984            | 2984            | 2984            |
| <b>Current liabilities</b>          |                 |                 |                 |                 |
| <b>Short term borrowings</b>        |                 |                 |                 |                 |
| Current liabilities and provisions  | 52,748          | 62,995          | 75,651          | 86,264          |
| Other current liabilities           | 28,721          | 30,194          | 31,062          | 35,042          |
| <b>Total equity and liabilities</b> | <b>1,65,859</b> | <b>1,96,851</b> | <b>2,27,372</b> | <b>2,40,765</b> |
| <b>ASSETS</b>                       |                 |                 |                 |                 |
| Net block                           | 46,876          | 50,605          | 53,571          | 52,907          |
| Capital work in progress            | 2,129           | 5,129           | 8,129           | 9,129           |
| Intangible assets                   | 4,748           | 6,248           | 6,748           | 7,248           |
| <b>Non current investments</b>      |                 |                 |                 |                 |
| Long term loans and advances        | 244             | 244             | 244             | 244             |
| Long term investments               | 33,164          | 39,664          | 46,564          | 53,464          |
| <b>Total non current assets</b>     | <b>87,161</b>   | <b>1,01,890</b> | <b>1,15,256</b> | <b>1,22,991</b> |
| <b>Current assets</b>               |                 |                 |                 |                 |
| Inventories                         | 17,099          | 19,029          | 24,636          | 28,246          |
| Trade receivables                   | 9,805           | 13,420          | 17,472          | 21,237          |
| Cash and cash bank                  | 10,044          | 15,837          | 18,326          | 11,588          |
| Short term loans and advances       | 241             | 168             | 100             | 100             |
| Other current assets                | 10,957          | 12,957          | 15,531          | 18,052          |
| <b>Total current assets</b>         | <b>78,697</b>   | <b>94,961</b>   | <b>1,12,117</b> | <b>1,17,773</b> |
| <b>Total Assets</b>                 | <b>1,65,859</b> | <b>1,96,851</b> | <b>2,27,372</b> | <b>2,40,765</b> |

**Cash Flow**

| YE Mar (₹ mn)                              | FY 18          | FY 19E         | FY 20E         | FY 21E         |
|--|----------------|----------------|----------------|----------------|
| <b>PBT</b>                                 | <b>15,626</b>  | <b>18,689</b>  | <b>22,528</b>  | <b>25,537</b>  |
| Depreciation                               | 5,546          | 6,271          | 7,034          | 7,664          |
| Interest                                   | 1,312          | 800            | 700            | 750            |
| Chng in working capital                    | -333           | 21,433         | 6,349          | 4,432          |
| Tax paid                                   | -4,149         | -6,566         | -9,202         | -10,945        |
| <b>Cash flow from operations (a)</b>       | <b>54,183</b>  | <b>33,092</b>  | <b>30,166</b>  | <b>16,097</b>  |
| <b>Capital expenditure</b>                 |                |                |                |                |
| Chng in investments                        | -7,457         | -6,000         | -5,500         | -5,500         |
| Other investing activities                 | -20,492        | -4,471         | -2,545         | -1,723         |
| <b>Cash flow from investing (b)</b>        | <b>-33,321</b> | <b>-23,471</b> | <b>-21,045</b> | <b>-15,223</b> |
| <b>Inc/dec in borrowings</b>               |                |                |                |                |
| <b>Dividend paid (incl. tax)</b>           | <b>-5,495</b>  | <b>-3,925</b>  | <b>-4,731</b>  | <b>-5,363</b>  |
| Other financing activities                 | -2,582         | -800           | -700           | -750           |
| <b>Cash flow from financing (c)</b>        | <b>-19,613</b> | <b>-3,725</b>  | <b>-6,631</b>  | <b>-7,613</b>  |
| <b>Net chng in cash (a+b+c)</b>            | <b>1,249</b>   | <b>5,896</b>   | <b>2,490</b>   | <b>-6,739</b>  |
| <b>Closing cash &amp; cash equivalents</b> | <b>9,940</b>   | <b>15,837</b>  | <b>18,326</b>  | <b>11,588</b>  |

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