Ashok Leyland Limited

Q3 FY19- Result Update

Sector: Auto

18th February, 2019

CMP (INR) (As on 18th Feb, 2019)	79.65
Target Price (INR)	113.0
Upside(%)	41.8%
Recommendation	**Strong Buy**

BSE Code	500477
NSE Code	ASHOKLEY
Reuters Ticker	ASOK.BO
Bloomberg Ticker	AL IN

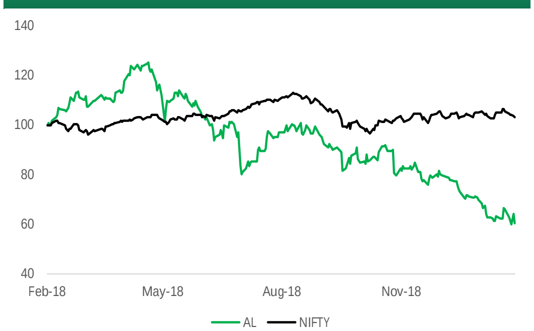
Stock Scan

Market cap (INR Cr.)	23,313.5
Outstanding Shares (Cr.)	292.7
Face Value (INR)	1.00
Dividend Yield(%)	3.03
TTM P/E (x)	13.36
Industry P/E (x)	13.58
Debt/Equity	0.14
Beta vs. Sensex	1.15
52 Week High/ Low (INR)	167.5/77.6
Avg. Daily Vol. (NSE)/1 yr.	20,738,000

Shareholding Pattern (%)

	Dec-2018	Sep-2018	Jun-2018
Promoters	51.12	51.12	51.13
Institutions	31.01	32.84	33.66
Non-institutions	17.87	16.04	15.21

Stock vs. Nifty (Relative Returns)



Source: NSE

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Company Overview

Ashok Leyland (AL), flagship of the Hinduja Group, is the 2nd largest manufacturer of commercial vehicle (CV) in India and 12th largest manufacturer of trucks globally. It is headquartered in Chennai and has 9 manufacturing facilities, out of which 7 are based out of India and the rest provide AL international exposure – a Bus manufacturing facility in RAK, UAE and one at Leeds, United Kingdom. The Co. has pioneered many disruptive technologies owing to the strong focus on R&D which has made it the first Indian company to receive OBD – II (on board diagnostic) certification for BS IV compliant engines, SCR (selective catalytic reduction), iGER (intelligent exhaust gas recirculation) and CNG technologies. Apart from CVs, AL is also present in other businesses like Power solutions, Defense etc. to reduce the impact of the cyclical nature of its core business.

Key Highlights

- Standalone operating revenue for Q3FY19 reported at INR6325.2 crore, down 12% YoY owing to softness in commercial vehicle demand. Reported operational revenue is significantly higher than our estimate of INR6145 crore due to higher than anticipated realization per vehicle. Due to steep rise in raw material Gross profit margin reduced by 44 bps YoY to 29.9%.

- Absolute EBITDA for the quarter under review stood at INR649.8 crore, down 22.6% YoY and it is higher than our estimate of INR584 crore. EBITDA margin dropped by 140bps YoY to 10.3% due to increase in employee benefit expense.

- Co. reported an a PAT of INR380.8 crore, down 21.5% YoY and it surpassed our estimate of INR338 crore and PAT margin dropped by 72 bps YoY to 6.02% due to lower other income and higher depreciation & amortization expense.

Exhibit 1: Financial Performance at a glance (Standalone)

Particulars (INR Cr.)	FY17A	FY18A	FY19E	FY20E	FY21E
Net Sales	20,156	26,248	31,913	37,854	39,628
Growth (%)	6.4%	30.2%	21.6%	18.6%	4.7%
Gross Profit	6,182	7,627	9,530	11,443	11,764
Gross Profit Margin	30.7%	29.1%	29.9%	30.2%	29.7%
EBITDA (ex OI)	2,218	2,739	3,157	3,979	3,885
EBITDA Margin	11.0%	10.4%	9.9%	10.5%	9.8%
Net Profit	1,223	1,562	1,890	2,430	2,348
Net Profit Margin	6.1%	6.0%	5.9%	6.4%	5.9%
EPS	4.18	5.34	6.46	8.30	8.02
BVPS	20.93	24.48	28.06	32.21	36.22
P/E (x)	24.9	19.5	16.1	12.5	13.0
P/BV (x)	5.0	4.2	3.7	3.2	2.9
EV/EBITDA (x)	13.9	10.9	9.8	7.9	8.0
ROAE (%)	21.2%	23.5%	24.6%	27.6%	23.4%
ROACE (%)	16.6%	20.8%	21.6%	23.9%	20.4%

Source: Company Data, SMIFS Research

Exhibit 2: Financial Performance (Standalone)

Particulars (in INR Crore)	Quarter Ended					Nine months ended		
	Q3 FY19	Q3 FY18	YoY %	Q2 FY19	QoQ %	Dec-18	Dec-17	YoY %
Net sales	6,245.2	7,051.5	-11.4%	7,480.1	-16.5%	19,891.4	17,314.2	14.9%
Other operating income	80.0	139.2	0.0%	140.9	0.0%	317.6	262.1	0.0%
Total operating income	6,325.2	7,190.7	-12.0%	7,621.1	-17.0%	20,209.0	17,576.3	15.0%
Cost of materials consumed	5,319.2	5,827.9	-8.7%	5,346.7	-0.5%	15,713.5	12,404.3	26.7%
Purchase of stock-in-trade	210.6	192.4	9.5%	159.9	31.7%	574.9	470.1	22.3%
(Increase)/decrease in inventories	(1,094.1)	(1,009.6)	8.4%	(8.9)	12206.7%	(2,038.1)	(691.2)	194.9%
Gross Profit	1,889.5	2,180.0	-13.3%	2,123.4	-11.0%	5,958.7	5,393.1	10.5%
Gross Profit margin (%)	*29.87*	*30.32*	*-44 bps*	*27.9*	*201 bps*	*29.5*	*30.7*	*-120 bps*
Employee benefit expense	500.1	476.6	4.9%	525.1	-4.8%	1,525.3	1,379.0	10.6%
Other expenses	739.8	864.0	-14.4%	769.3	-3.8%	2,283.1	2,176.2	4.9%
Total Expenses	5,675.6	6,351.4	-10.6%	6,792.0	-16.4%	18,058.7	15,738.4	14.7%
EBITDA (Ex OI)	649.6	839.3	-22.6%	829.0	-21.6%	2,150.3	1,837.9	17.0%
EBITDA margin (%)	*10.27*	*11.67*	*-140 bps*	*10.88*	*-61 bps*	*10.64*	*10.46*	*18 bps*
Other income	20.8	41.7	-50.2%	27.6	-24.6%	100.9	137.2	-26.5%
Depreciation & amortization	160.7	146.0	10.1%	148.1	8.5%	461.3	441.1	4.6%
EBIT	509.8	735.1	-30.7%	708.5	-28.1%	1,789.9	1,534.0	16.7%
EBIT Margin (%)	*8.06*	*10.22*	*-216 bps*	*9.30*	*-124 bps*	*8.86*	*8.73*	*13 bps*
Interest cost	19.2	36.8	-47.9%	20.4	-6.1%	53.8	122.9	-56.2%
Profit before tax	490.6	698.3	-29.7%	688.1	-29%	1,736.2	1,411.1	23.0%
PBT margin (%)	*7.76*	*9.71*	*-196 bps*	*9.03*	*-127 bps*	*8.59*	*8.03*	*56 bps*
Tax	102.7	207.9	-50.6%	143.1	-28%	360.1	405.6	-11.2%
Adj. Profit after tax	380.8	484.9	-21.5%	527.7	-27.8%	1,330.2	974.6	36.5%
PAT margin (%)	*6.02*	*6.74*	*-72 bps*	*6.92*	*-90 bps*	*6.58*	*5.55*	*104 bps*
EPS	1.30	1.66	-21.7%	1.80	-27.8%	4.53	3.33	36.0%
EPS (Diluted)	1.30	1.65	-21.2%	1.80	-27.8%	4.53	3.32	36.4%

Source: Company Data & SMIFS Research

Actual Vs. Estimates

SMIFS Estimates (INR Cr.)	Actual	Estimates	Variance	Remarks
Revenue	6,325	6,145	2.9%	Despite softness in CV demand Co. managed to beat revenue estimates due to higher than anticipated realisation per unit of vehicle. Co.surpassed Bloomberg EBITDA estimate of INR584 crore on the back of favourable product mix. Co. also surpassed our PAT estimate of INR338 crore owing to sharp drop in interest expense and lower effective tax rate.
EBITDA	650	584	11.2%	
EBITDA margin (%)	*10.3*	*9.5*	*77 bps*	
PAT	381	338	12.7%	
PAT margin (%)	*6.0*	*5.5*	*52 bps*	

Source: Company Data & SMIFS Research

Concall Highlights

- During Q3FY19, Co. experienced a dip of 150 bps in its M&HCV market share to 31.9% as it refuses to participate in heavy discounts offered by other players in that space.

- NBFC crisis and new axle load norm impacted the Q3FY19 demand for Commercial Vehicles and export demand during the same period was also subdued owing to poor demand from Middle-East (due to volatile oil prices) and Sri Lanka (due to high degree of political uncertainty).

- Management is optimistic about Pre-Buy to set in Q2FY20 and to continue till Q4FY20 and guiding for a flat FY21 and also indicated that implementation of scrappage policy is expected to neutralize the anticipated drop in volume in FY21. Bangladesh is expected to be a high volume export market.

- In FY19, Co. is guiding for a INR1000 crore, out of which INR600 crore has already been invested and CapEx for FY20 is expected to be around INR1000 crore.

- Current Channel inventory is at a normal level. Co. was having an inventory of 12,763 vehicles by the end of December'18 and in Jan'19 Co. managed to reduce the inventory level by 3,500 vehicles.

- Modularity will help the Co. to contain the cost and it is likely to expand the EBITDA margin by 150 bps in FY21-22.

- In Jan'19, Co. has opted for 2% price hike on selective models and despite that Co. managed to post a positive YoY growth in Jan'19.

- In the aftermarket segment, Co. has posted a robust 25% YoY growth. Currently, It has 30% penetration in the post warranty aftermarket space and Management is confident about increasing it to 60% going forward.

- Management has indicated that Co. will be launching a whole lot of new products in the LCV segment in coming few quarters and will have a complete LCV product portfolio.

- During Q3FY19, no new major NPA is added to the books of Hinduja Leyland Finance (HLF) and business is in a very good shape. M&HCV financing contributes 50% of its loan-book and the rest is contributed by 2Ws, Construction Equipment and others.

Outlook & Valuation

Going forward we believe, ongoing proliferation of "Hub & Spoke" model, an all-round pickup in economic activity, introduction of EVs, enactment of weigh-in-motion and likely implementation of scrappage policy should result in healthy volume growth for the Co. Despite policy related fluctuations the CV space has remained buoyant and AL is perfectly poised to take up the opportunity considering its 50% market share in the HCV segment which is currently experiencing strong growth due to GST led structural change in the logistics sector.

Gain in market share is expected to be limited for AL considering TML's aggressive pricing strategy but AL's dominance in the higher tonnage segment is likely to continue. Operating leverage, increasing global footprint, investment in EV, favourable product mix and LCV business consolidation are expected to drive margin expansion and strong earnings growth.

However, we believe transition of emission standard is not going to augur well for CV OEMs as volume de-growth is expected in FY21 owing to 8-10% price hike. Implementation of scrappage policy can fend off the threat to some extent that is expected from BS VI implementation. So the earnings growth in AL from FY21 will hinge upon the implementation of scrappage policy to a great extent.

Considering the healthy channel inventory, slew of new launches in the LCV space, market share gain in Jan'19 despite opting for 2% price hike and robust balance sheet we are maintaining our Target Price of **INR113** as stated in our Initiating Coverage Report dated 27th December,2018.

Please find below the link of our previous reports:

Date: 27th Dec,2018 **CMP: INR103.9** **Target Price: INR113.0**

https://www.smifs.com/files/reports/636815812926944020_Stewart%20&%20Mackertich%20Research_Initiating%20Coverage%20Report_Ashok%20Leyland.pdf

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Stock Recommendation	Expected absolute returns (%) over 12 months
Strong Buy	>20%
Buy	between 12% and 20%
Accumulate	between 6% and 12%
Hold	between 0% and 6%
Sell	0 to <-10%
Neutral	No Rating
Stock Recommendation	Expected absolute returns (%) over 12 months

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