

| | |
|-----------|-------------|
| Industry | Automobiles |
| Bloomberg | AL IN |
| BSE CODE | 500477 |

Working on next leg of growth

| | |
|-------------------------|------------|
| RATING | BUY |
| CMP | 106 |
| Price Target | 135 |
| Potential Upside | 27% |

| | |
|------------------------|---|
| Rating Change | ↔ |
| Estimate Change | ↓ |
| Target Change | ↓ |

Stock Info

| | |
|---------------------|---------|
| 52wk Range H/L | 168/103 |
| Mkt Capital (Rs Cr) | 31219 |
| Free float (%) | 49% |
| Avg. Vol 1M (,000) | 22895 |
| No. of Shares (Cr.) | 294 |
| Promoters Pledged % | 0% |

Research Analyst

NAVEEN KUMAR DUBEY

Naveen.dubey@narnolia.com

+91-22-62701235

Swati Singh

Swati.singh@narnolia.com

+91-22-62701224

Key Highlights

- ❑ Ashok Leyland is the second largest commercial vehicle manufacturer in India with market share of over 33%. The company has the best margin profile in the commercial vehicle space in domestic market.
- ❑ Ashok Leyland is looking to invest Rs.400 crores over the next couple of years towards development of new LCV platform and also aims to double its market share to 30% from current 16% post 2020.
- ❑ Mr. Vinod Dasari has decided to step down as MD & CEO w.e.f 31 March 2019. Mr. Dheeraj Hinduja has become Executive Chairman from immediate effect and he will be active only till the new CEO comes in..
- ❑ In order to diversify its product portfolio the company has reduced truck revenues to 60% from 80% in FY14-15. The ICV share has also increased to 25% from 10-14% in last 3-4 years.

2Q FY19 Result Update

Ashok Leyland has posted revenue growth of 26% YoY primarily driven by 27% YoY volume growth while realization declined by 1%YoY. The M&HCV volumes grew by robust 22% YoY while LCV volumes grew by 42% YoY. EBITDA margin maintained at over 10.5% on account of reduced warranty charges, tighter cost control and operating leverage benefit. PAT also grew handsomely by 38%YoY to Rs.460 crores.

View and Valuation

ASHOKLEY has reported impressive quarterly performance on account of operating leverage benefit and tighter cost control. Though, the gross margin declined by 300bps on sequential basis due to rising commodity cost and absence of defence supplies. The industry has witnessed slowdown in the current NBFC liquidity crunch in last few weeks and the management expects it to continue for next 1-2 months. The commercial vehicle industry has posted growth of over 30%YoY in 1HFY19 so we expect growth for FY19 would be in the range of 15-20%. Going ahead the growth will be driven by continued infrastructure development, pre buying due to BS-VI implementation and mandatory scrappage policy. The steel prices in the domestic market continue to be on the higher side and hence there could be some pressure on commodity side in 2HFY19 also. However the company will take price hikes in order to mitigate some of the cost pressure. Considering the continued commodity cost pressure in 2HFY19 and heavy discounting in the industry we reduce our FY19/20 EPS estimates by 11%/4% respectively. We expect revenue and PAT to grow at 12% and 26% CAGR over FY18-20. We value the stock at 16x FY20e EPS to arrive at a target price of Rs.135 and recommend BUY.

Key Risks to our rating and target

- ❑ Increase in discounts on MHCVs

| KEY FINANCIAL/VALUATIONS | FY16 | FY17 | FY18 | FY19E | FY20E |
|--------------------------|-------|-------|-------|-------|-------|
| Net Sales | 18937 | 20019 | 26248 | 29499 | 33133 |
| EBITDA | 2255 | 2203 | 2739 | 3181 | 3876 |
| EBIT | 1767 | 1685 | 2184 | 2594 | 3263 |
| PAT | 390 | 1223 | 1563 | 1909 | 2477 |
| EPS (Rs) | 1.4 | 4.3 | 5.3 | 6.5 | 8.5 |
| EPS growth (%) | 16.4 | 213.9 | 24.2 | 22.2 | 29.8 |
| ROE (%) | 7.2 | 20.0 | 21.8 | 23.1 | 25.5 |
| ROCE (%) | 24.4 | 23.2 | 28.8 | 30.9 | 33.7 |
| BV | 19.0 | 21.5 | 24.5 | 28.2 | 33.1 |
| P/B (X) | 5.7 | 3.9 | 6.6 | 3.8 | 3.2 |
| P/E (x) | 79.3 | 19.4 | 30.2 | 16.3 | 12.5 |

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2QFY19 Results

PAT below expectation

| Financials | 2QFY18 | 3QFY18 | 4QFY18 | 1QFY19 | 2QFY19 | YoY % | QoQ% | FY17 | FY18 | YoY % |
|--------------|-----------|-----------|-----------|-----------|-----------|-------|------|-----------|-----------|--------|
| Volumes | 40985 | 46657 | 58735 | 42127 | 51958 | 27% | 23% | 145068 | 174861 | 20.5% |
| Realization | 1,475,391 | 1,524,565 | 1,493,571 | 1,483,639 | 1,464,256 | -1% | -1% | 1,379,950 | 1,501,073 | 8.8% |
| Net Sales | 6,047 | 7,113 | 8,772 | 6,250 | 7,608 | 26% | 22% | 20,019 | 26,248 | 31.1% |
| Other Income | 56 | 38 | 58 | 50 | 28 | -49% | -44% | 136 | 190 | 39.3% |
| Total Income | 6,103 | 7,151 | 8,830 | 6,300 | 7,636 | 25% | 21% | 20,155 | 26,438 | 31.2% |
| COGS | 4,307 | 5,082 | 6,306 | 4,351 | 5,529 | 28% | 27% | 13,957 | 18,621 | 33.4% |
| Staff Cost | 482 | 492 | 455 | 493 | 517 | 7% | 5% | 1,531 | 1,812 | 18.4% |
| Other Exp. | 645 | 751 | 979 | 758 | 756 | 17% | 0% | 2,328 | 3,076 | 32.1% |
| Expenditure | 5,435 | 6,325 | 7,740 | 5,603 | 6,802 | 25% | 21% | 17,816 | 23,509 | 32.0% |
| EBITDA | 612 | 788 | 1,033 | 648 | 806 | 32% | 24% | 2,203 | 2,739 | 24.4% |
| Depreciation | 141 | 135 | 146 | 143 | 140 | -1% | -2% | 518 | 555 | 7.1% |
| EBIT | 471 | 653 | 886 | 505 | 666 | 41% | 32% | 1,685 | 2,184 | 29.7% |
| Interest | 41 | 34 | 20 | 12 | 17 | -58% | 50% | 155 | 131 | -15.5% |
| PBT | 485 | 658 | 924 | 543 | 677 | 39% | 25% | 1,666 | 2,243 | 34.7% |
| Excpt. Item | - | - | (0) | 15 | 16 | 0% | 0% | (351) | (13) | 0.0% |
| Tax | 148 | 208 | 263 | 152 | 201 | 35% | 32% | 107 | 668 | 524.4% |
| PAT | 334 | 450 | 668 | 370 | 460 | 37% | 24% | 1,223 | 1,563 | 27.8% |

Robust volume growth

Net revenue grew by 26%YoY to Rs.7608 crores (vs our estimate of Rs.7714 crores) in 2QFY19 primarily driven by 27% YoY volume growth. Heavy discounting practices by competitors and shift in product mix towards LCVs kept realizations were down by 1%YoY.

The M&HCV volumes grew handsomely by 22% YoY to 38386 units on account of increased construction activity in the country. LCV volumes surged by 42%YoY to 13572 units and the demand was triggered by new product launch and increasing last mile connectivity across rural markets. Exports market has witnessed decline due to uncertainty in two of the major export destination; Sri Lanka and Middle East.

Margin expansion on the back of operating leverage benefit & cost control

The raw material cost was higher during the quarter due to absence of defence supplies (VFJ: Vehicle Factory Jabalpur) which resulted in 300bps reduction in Gross margins. However, EBITDA margin maintained at over 10.5% on account of reduced warranty charges, tighter cost control and operating leverage benefit.

Higher other income and lower tax boosted PAT growth

PAT also grew by 38%YoY to Rs.460 crores (vs our estimate of Rs.533 crores). Higher sales and better cost efficiencies led to 50bps YoY expansion in margins.

Concall highlights

- ❑ Ashok Leyland's market share for the quarter was 35% (33.2% in 2QFY18).
- ❑ The management expects 15-20% volume growth in FY19 largely driven by infrastructure development activities (40-45% of total truck sales).
- ❑ The growth in FY20 is also expected to be strong and it will further be boosted by pre buying due to BS-VI implementation (8-10% price increase).
- ❑ The industry may witness slowdown in demand after BS-VI implementation hence, the government may bring the mandatory scrappage policy (2-3 lakh vehicles may go out of the system) in order to maintain the demand in the system.
- ❑ The company will be comfortable with either export or change the engines of left over BS-IV vehicles after the BS-VI implementation.
- ❑ The management has indicated that the steel prices in the domestic market continue to be on the higher side and hence there could be some pressure on commodity side in 2HFY19.
- ❑ The company has taken 2% price increase in November.
- ❑ The company currently has 7700 units of inventory and generally the dealer inventory remains at 2 weeks.
- ❑ The management does not see any issue on the demand side due to increased axle load norm. The company is already selling increased axle load trucks to the customers on their demand.

Exhibit: Volume and Volume Growth Trend

Volume growth was driven by strong growth in construction equipment segment



Exhibit: Realisation and Realisation Growth Trend

Higher discounting and shift in product mix towards LCVs led to decline in realization in 2QFY19

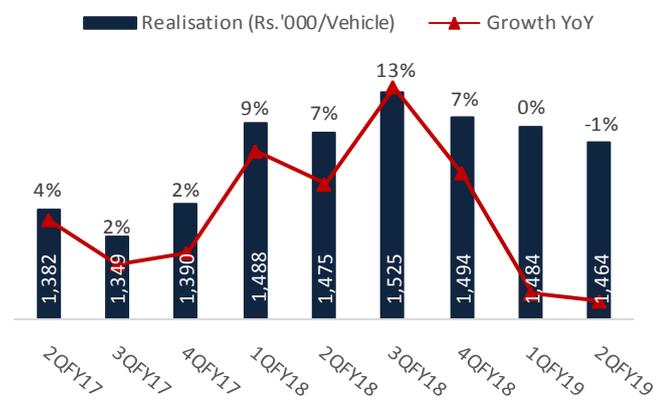


Exhibit: EBITDA (Rs. Crore) and EBITDA Margin Trend

Margin expanded on account of reduced warranty charges, tighter cost control and operating leverage benefit.



Exhibit: PAT (Rs. Crore) and PAT Margin Trend

Higher sales and better cost efficiencies led to 50bps YoY expansion in margins.

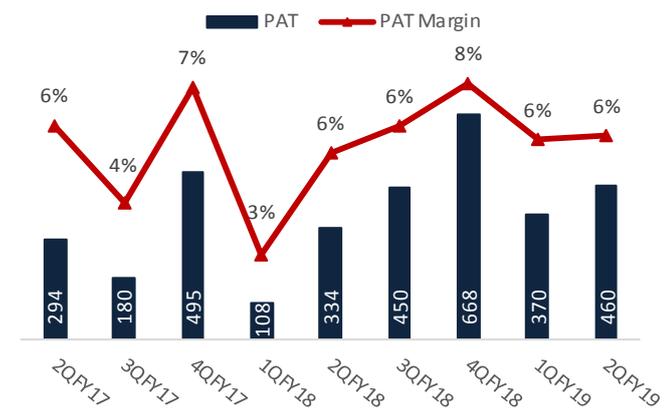


Exhibit: Market Share of M&HCV Segment

Heavy discounting in the industry leads to 170 bps decline in market share

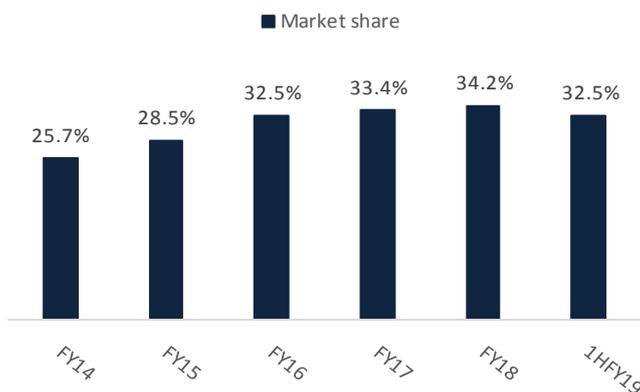
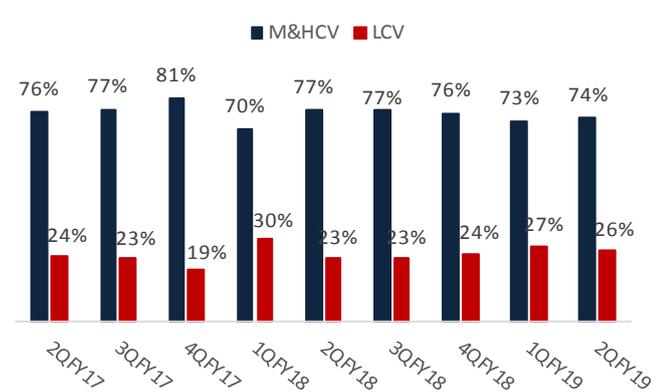


Exhibit: Product Mix in M&HCV Segment

Despite strong sales of higher tonnage trucks product mix shifted towards LCVs.



Financial Details

Balance Sheet

| Y/E March | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|------------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Share Capital | 266 | 266 | 285 | 285 | 285 | 293 | 293 | 293 |
| Reserves | 4,189 | 4,182 | 4,834 | 5,123 | 5,841 | 6,872 | 7,973 | 9,401 |
| Networth | 4,455 | 4,448 | 5,119 | 5,408 | 6,126 | 7,165 | 8,266 | 9,694 |
| Debt | 3,505 | 3,884 | 2,591 | 1,846 | 1,345 | 516 | 166 | 25 |
| Other Non Cur Liab | 608 | 477 | 591 | 481 | 299 | 757 | 789 | 824 |
| Total Capital Employed | 7,193 | 7,744 | 7,685 | 7,229 | 7,272 | 7,580 | 8,381 | 9,694 |
| Net Fixed Assets (incl CWIP) | 5,971 | 5,841 | 5,376 | 4,868 | 5,177 | 5,375 | 5,638 | 5,675 |
| Non Cur Investments | 2,338 | 2,405 | 2,240 | 1,980 | 2,002 | 2,747 | 2,888 | 3,501 |
| Other Non Cur Asst | 492 | 1,035 | 1,002 | 633 | 588 | 509 | 509 | 509 |
| Non Curr Assets | 8,800 | 9,281 | 8,618 | 7,593 | 7,940 | 8,716 | 9,120 | 9,769 |
| Inventory | 1,896 | 1,189 | 1,399 | 1,625 | 2,501 | 1,710 | 2,101 | 2,360 |
| Debtors | 1,419 | 1,299 | 1,258 | 1,251 | 860 | 980 | 1,212 | 1,362 |
| Cash & Bank | 14 | 12 | 751 | 1,593 | 912 | 1,004 | 939 | 1,094 |
| Other Curr Assets | 967 | 1,027 | 1,285 | 586 | 1,312 | 3,797 | 4,024 | 4,984 |
| Curr Assets | 4,297 | 3,527 | 4,693 | 5,181 | 5,737 | 7,870 | 8,654 | 10,177 |
| Creditors | 2,485 | 2,214 | 2,828 | 2,563 | 3,052 | 4,659 | 4,849 | 5,447 |
| Provisons (both) | 309 | 88 | 256 | 189 | 484 | 616 | 693 | 778 |
| Other Curr Liab | 1,735 | 1,697 | 1,926 | 2,113 | 2,446 | 2,861 | 3,011 | 3,179 |
| Curr Liabilities | 4,529 | 3,999 | 5,011 | 4,865 | 5,982 | 8,147 | 8,553 | 9,403 |
| Net Curr Assets | (233) | (472) | (318) | 316 | (246) | (277) | 102 | 774 |
| Total Assets | 13,097 | 12,808 | 13,311 | 12,774 | 13,800 | 16,586 | 17,774 | 19,946 |

Income Statement

| Y/E March | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|----------------------------------|------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Revenue from Operation | 12,481 | 9,943 | 13,562 | 18,937 | 20,019 | 26,248 | 29,499 | 33,133 |
| Change (%) | (3) | (20) | 36 | 40 | 6 | 31 | 12 | 12 |
| Other Income | 62 | 116 | 124 | 118 | 136 | 190 | 196 | 241 |
| EBITDA | 876 | 117 | 1,027 | 2,255 | 2,203 | 2,739 | 3,181 | 3,876 |
| Change (%) | (30) | (87) | 778 | 120 | (2) | 24 | 16 | 22 |
| Margin (%) | 7.0 | 1.2 | 7.6 | 11.9 | 11.0 | 10.4 | 10.8 | 11.7 |
| Depr & Amor. | 381 | 377 | 416 | 488 | 518 | 555 | 587 | 613 |
| EBIT | 496 | (260) | 610 | 1,767 | 1,685 | 2,184 | 2,594 | 3,263 |
| Int. & other fin. Cost | 377 | 453 | 394 | 248 | 155 | 131 | 50 | 16 |
| EBT | 181 | (597) | 341 | 1,637 | 1,666 | 2,243 | 2,739 | 3,488 |
| Exp Item | 290 | 506 | 101 | (815) | (351) | (13) | (15) | - |
| Tax | 37 | (121) | 107 | 437 | 107 | 668 | 794 | 1,012 |
| Minority Int & P/L share of Ass. | | | | | | | | |
| Reported PAT | 434 | 29 | 335 | 390 | 1,223 | 1,563 | 1,909 | 2,477 |
| Adjusted PAT | 434 | 29 | 335 | 390 | 1,223 | 1,563 | 1,909 | 2,477 |
| Change (%) | (23) | (93) | 1,040 | 16 | 214 | 28 | 22 | 30 |
| Margin(%) | 3.5 | 0.3 | 2.5 | 2.1 | 6.1 | 6.0 | 6.5 | 7.5 |

Financial Details

Key Ratios

| Y/E March | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|--------------------|------|------|-------|-------|-------|-------|-------|-------|
| ROE | 10% | 1% | 7% | 7% | 20% | 22% | 23% | 26% |
| ROCE | 7% | -3% | 8% | 24% | 23% | 29% | 31% | 34% |
| Asset Turnover | 1.0 | 0.8 | 1.0 | 1.5 | 1.5 | 1.6 | 1.7 | 1.7 |
| Debtor Days | 42 | 48 | 34 | 24 | 16 | 14 | 15 | 15 |
| Inv Days | 55 | 44 | 38 | 31 | 46 | 24 | 26 | 26 |
| Payable Days | 73 | 81 | 76 | 49 | 56 | 65 | 60 | 60 |
| Int Coverage | 1 | (1) | 2 | 7 | 11 | 17 | 52 | 202 |
| P/E | 13 | 215 | 29 | 79 | 19 | 30 | 16 | 13 |
| Price / Book Value | 1 | 1 | 2 | 6 | 4 | 7 | 4 | 3 |
| EV/EBITDA | 10 | 100 | 15 | 16 | 14 | 20 | 13 | 8 |
| FCF per Share | 84 | 349 | 1,571 | 1,533 | 1,789 | 4,886 | 1,480 | 2,843 |
| Div Yield | 2.7% | 0.0% | 1.3% | 0.9% | 1.9% | 1.5% | 2.2% | 2.8% |

Cash Flow Statement

| Y/E March | FY13 | FY14 | FY15 | FY16 | FY17 | FY18 | FY19E | FY20E |
|------------------------------|---------|-------|---------|---------|---------|---------|---------|---------|
| PBT | 471 | (91) | 442 | 1,169 | 1,223 | 1,563 | 2,739 | 3,488 |
| (inc)/Dec in Working Capital | (49) | 370 | 705 | (128) | 190 | 2,962 | (253) | 387 |
| Non Cash Op Exp | 381 | 377 | 416 | 444 | 518 | 555 | 587 | 613 |
| Int Paid (+) | 377 | 453 | 394 | 274 | 155 | 131 | 50 | 16 |
| Tax Paid | (110) | (30) | (50) | (441) | (348) | (415) | (794) | (1,012) |
| others | (342) | (523) | (130) | 358 | 13 | (106) | - | - |
| CF from Op. Activities | 728 | 556 | 1,777 | 1,676 | 2,155 | 5,418 | 2,330 | 3,493 |
| (inc)/Dec in FA & CWIP | (649) | (220) | (211) | (147) | (378) | (537) | (850) | (650) |
| Free Cashflow | 79 | 337 | 1,565 | 1,529 | 1,776 | 4,881 | 1,480 | 2,843 |
| (Pur)/Sale of Inv | (99) | 481 | (49) | 854 | (2,166) | (2,880) | (278) | (1,473) |
| others | (2) | 138 | 387 | 154 | (28) | 85 | - | - |
| CF from Inv. Activities | (1,164) | (110) | 102 | 388 | (1,477) | (3,332) | (1,128) | (2,123) |
| inc/(dec) in NW | 243 | (7) | 671 | 289 | 719 | 1,039 | 1,101 | 1,428 |
| inc/(dec) in Debt | 1,100 | 183 | (1,424) | (783) | (773) | (1,154) | (350) | (141) |
| Int. Paid | (363) | (436) | (406) | (296) | (164) | (146) | (50) | (16) |
| Div Paid (inc tax) | (309) | (187) | - | (154) | (325) | (549) | (808) | (1,048) |
| others | - | - | 667 | - | - | 5 | - | - |
| CF from Fin. Activities | 417 | (449) | (1,179) | (1,233) | (1,372) | (1,961) | (1,208) | (1,205) |
| Inc(Dec) in Cash | (19) | (2) | 699 | 830 | (694) | 125 | (6) | 165 |
| Add: Opening Balance | 27 | 8 | 5 | 705 | 1,563 | 869 | 994 | 928 |
| Closing Balance | 8 | 5 | 705 | 1,538 | 869 | 994 | 988 | 1,093 |

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| | |
|---|-----|
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|---|-----|

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Correspondence Office Address: Arch Waterfront, 5th Floor, Block GP, Saltlake, Sector 5, Kolkata 700 091; Tel No.: 033-40541700; www.narnolia.com.

Registered Office Address: Marble Arch, Office 201, 2nd Floor, 236B, AJC Bose Road, Kolkata 700 020; Tel No.: 033-4050 1500; www.narnolia.com

Compliance Officer: Manish Kr Agarwal, Email Id: mkagarwal@narnolia.com, Contact No.:033-40541700.

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