

Ashok Leyland

BSE SENSEX	S&P CNX
40,286	11,872
Bloomberg	AL IN
Equity Shares (m)	2,927
M.Cap.(INRb)/(USDb)	232.1 / 3.2
52-Week Range (INR)	114 / 57
1, 6, 12 Rel. Per (%)	10/-12/-40
12M Avg Val (INR M)	2384
Free float (%)	48.9

Financials & Valuations (INR b)

Y/E Mar	2019	2020E	2021E
Sales	290.5	187.1	233.7
EBITDA	31.4	12.9	20.9
NP	20.3	4.5	10.2
Adj. EPS (INR)	6.9	1.5	3.5
EPS Gr. (%)	16.4	-77.8	126.8
BV/Sh. (INR)	28.4	27.0	27.8
RoE (%)	26.0	5.5	12.7
RoCE (%)	23.2	5.4	11.4
P/E (x)	11.4	51.6	22.7
EV/EBITDA (x)	7.2	18.9	11.5
Div. Yield (%)	4.3	2.8	2.8

Shareholding pattern (%)

	Sep-19	Jun-19	Sep-18
Promoter	51.1	51.1	51.1
DII	13.1	11.0	10.0
FII	17.1	18.8	22.9
Others	18.8	19.1	16.0

Note: FII Includes depository receipts

CMP: INR79
TP: INR95 (+20%)
Buy

Well prepared for the next leg of growth...

... through differentiated BS6 solution, modular platform, LCVs, exports

We attended Ashok Leyland's (AL) investor meet at its Technical Centre in Chennai. Apart from showcasing its BS6-ready products on the modular platform, senior management [presented on the strategy](#) for future growth. Key insights from the meet:

- AL's focus is on retaining profitability/preserving cash over the short term and reducing volatility/growing business over the long term.
- The company is BS6-ready with differentiated solutions offering lowest total cost of ownership (TCO) for its customers.
- The modular platform is likely to provide it with a competitive advantage by facilitating better TCO and RoI to customers.
- LCV business appears set to expand in the addressable market by filling product gaps (in >2 ton segments).
- Exports business promise is likely to get realized with a relevant and wider product portfolio for the first time.
- AL continues emphasizing on cost and capital allocation with an objective to get multiplier effect of every penny spent.
- Domestic M&HCV volumes appear to have bottomed out, and systemic inventory is now very comfortable. Green shoots are visible, although it is difficult to ascertain the timing of a sustainable volumes recovery.

Valuation and view: Although the worst appears to be over for the CV industry, volumes are likely to remain volatile due to the upcoming BS6 transition. Unlike in the previous cycles, AL is on a very strong footing (lean cost structure and net cash balance sheet) and focused on adding new revenue/profit pools. Valuations at ~22.7x FY21E EPS and ~11.5x EV/EBITDA are reasonable in view of early recovery cycle earnings. We maintain our Buy rating with a target price of INR95 (10x Sep'21E EV/EBITDA + INR10/sh for HLF post 20% HoldCo discount].

BS6: Aiming to gain competitive advantage through differentiated approach

- For AL, differentiation on technology has been core of its success - e.g. using in-line FIP during the BS3 transition or iEGR during the BS4 transition - which has helped it to gain market share during such transitions.
- For BS6 compliance, AL is adopting the Mid NOx solution, which is based on iEGR+SCR+DPF, as against the high NOx (SCR+DPF) strategy of competitors.
- AL's solution requires low EGR and medium SCR, which results in almost half consumption of urea. According to management, this solution is more suited for the Indian conditions, offers better TCO and also high durability.
- AL's choice of EGR+SCR was driven by the tighter timelines for the BS6 transition. This approach required limited changes to the existing BS4 engines and at the same time provides best TCO to customers.
- It has done rigorous validation for its BS6 solutions with over 5m KMs and is the first CV player in India to get BS6 certification from the Automotive Research Association of India (ARAI).

Jinesh Gandhi - Research analyst (Jinesh@MotilalOswal.com); +91 22 6129 1524

Aanshu Agarwal - Research analyst (Aanshu.Agarwal@MotilalOswal.com); +91 22 7193 4337

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Modular Business (MBP): Win-win for AL and its customers

- AL has developed a new modular platform for BS6 products on which it can offer over 5,000 variants. In BS4, it has three platforms on which it offers ~400 variants. This has been achieved through higher commonality or standardization of parts. Despite a 30% increase in complexity under BS6, MBP has ensured lesser parts than under BS4 (8k parts v/s 12k parts).
- Benefits of modular platform for AL are multi-fold (a) faster time to market and lower development cost, (b) less number of parts, more variants, (c) lesser Takt time despite a 30% increase in complexity in BS6, (d) lesser complexity in manufacturing, (e) leaner inventory and inventory cost, (f) greater reliability and (e) higher economies of scale.
- MBP would cover the entire range of M&HCV trucks (15-55 ton), including RHD and LHD (for the first time), enabling it to address many more international markets.
- Benefits of modular platform to customers are higher configurability/customization of trucks to suit their applications, resulting in better TCO and RoI.
- For ICVs, it has worked on the existing platforms (e-Comet and Boss) to make it as much modular as possible.
- In buses, the focus is on commonality (v/s modularity) and fully building solutions with enhanced variants.

LCVs: Doubling of addressable market to drive growth

- Management expects the LCV segment to be less cyclical and grow faster than M&HCVs, resulting in an increase in the share of LCVs in CVs from ~60% now to 70% (in line with the global average).
- In segments where AL is present, it enjoys ~18.5% market share. This has been driven despite products being priced at premium to competitors.
- AL addresses ~34% of the LCV market with three products (Dost, Mitr and Partner). It would be launching LCV models under Project Phoenix from Mar'20, with a new product every three months thereafter in LHD and RHD.
- The company will have presence in all segments >2ton, as it expects the <2ton segment to be substantially impacted under the BS6 era due to very high cost inflation. Post new launches under Project Phoenix, its addressable market will likely increase to ~65%.

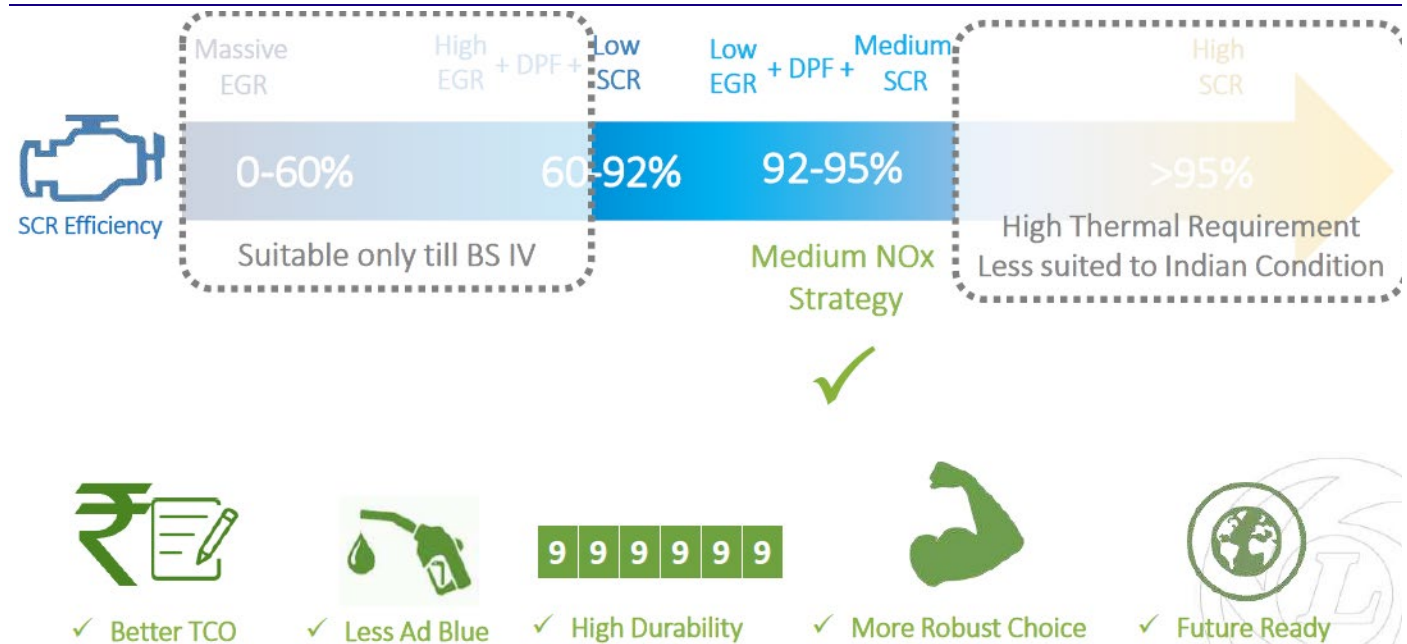
Exports: Getting ready with relevant product portfolio

- AL's export aspirations have not yet been met due to the weakness in its key markets and the lack of a wide product portfolio. Post BS6, it will have more complete product portfolio along with the LHD option.
- Apart from its existing strength in SAARC and GCC region, the company is in the process of opening up Africa, ASEAN and CIS markets. It plans to position its products slightly below Japanese and Korean competitors but at a premium to Chinese players.
- It has started customer engagement and is getting good response from distributors based on its market-specific product portfolio plans.

Other takeaways

- Defence business is yet to see conversion of tenders it won into business, though the opportunity remains very large.
- Customer Solutions Business (CSB) is targeting to capture the whole lifecycle relationship rather than just initial sale of truck. Over a period of time, this will transform AL from a product company to having an overlay of services and solutions. In CSB, it is targeting parts, finance, fuel (co-branded prepaid cards), telematics and resale.
- Domestic M&HCV volumes appear to have bottomed out and systemic inventory is now very comfortable. Green shoots are visible, although it is difficult to ascertain when volumes would recover sustainably. It is seeing some recovery in inquiries ahead of the BS6 transition.
- Scrappage policy can drive annual incremental volumes of 100-150k if implemented with right incentives for vehicles above 15 years.
- In the tippers segment, it has filled the gaps in its portfolio and strengthened its presence in weaker markets. This will likely help it improve market share in this segment.
- Capex: For FY20, it would be investing ~INR18b in regulatory changes and capability development. For FY21, it expects a capex of INR5-7b based on the current demand outlook.

Exhibit 1: AL's approach to BS6 compliance

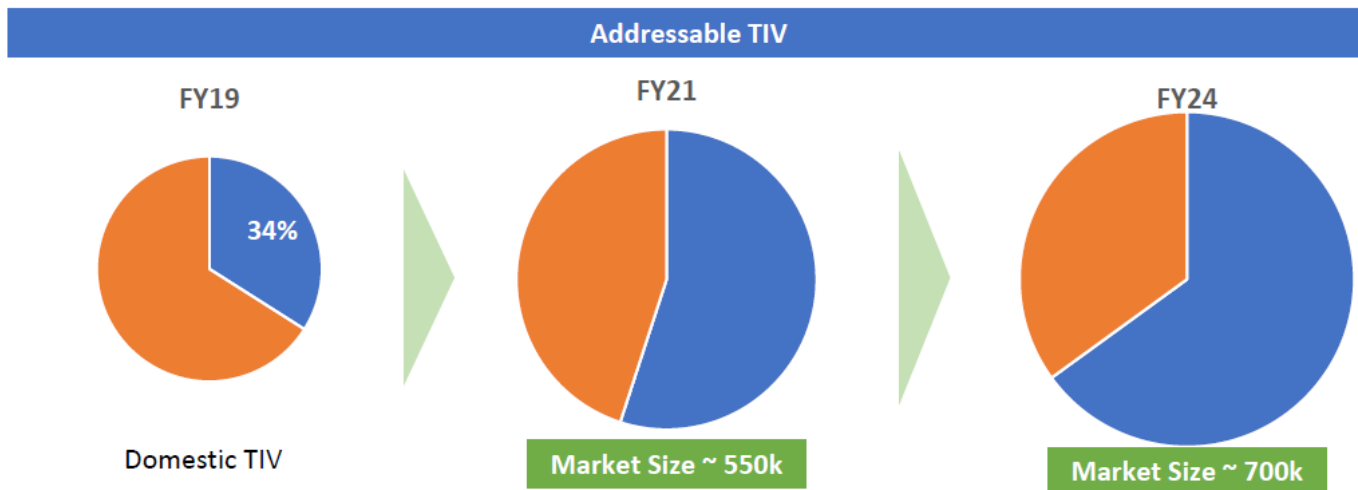


Source: Company

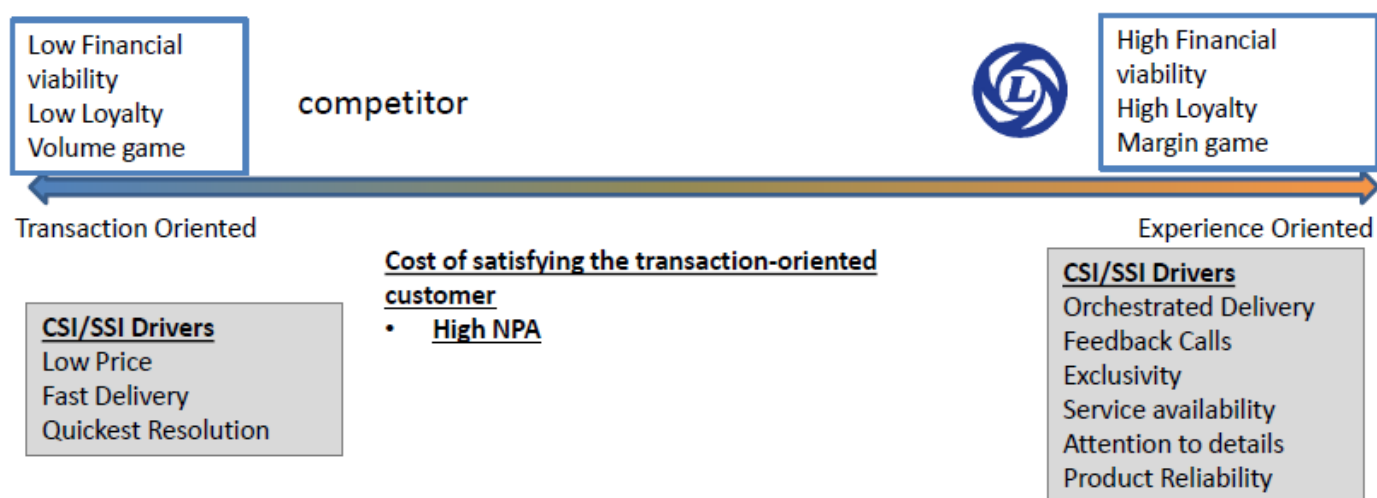
Exhibit 2: LCVs: AL's target is to increase addressable market from current ~34% to ~65% in the next few years

Addressable size of LCV market will increase significantly over the years

Segments	SCV		LCV Cargo		LCV Passenger		
Sub-segments	0-2 T	2 – 3.5 T	3.5 – 6T	6 – 7.5T	9 – 13 seater	16 – 20 seater	24 – 32 Seater

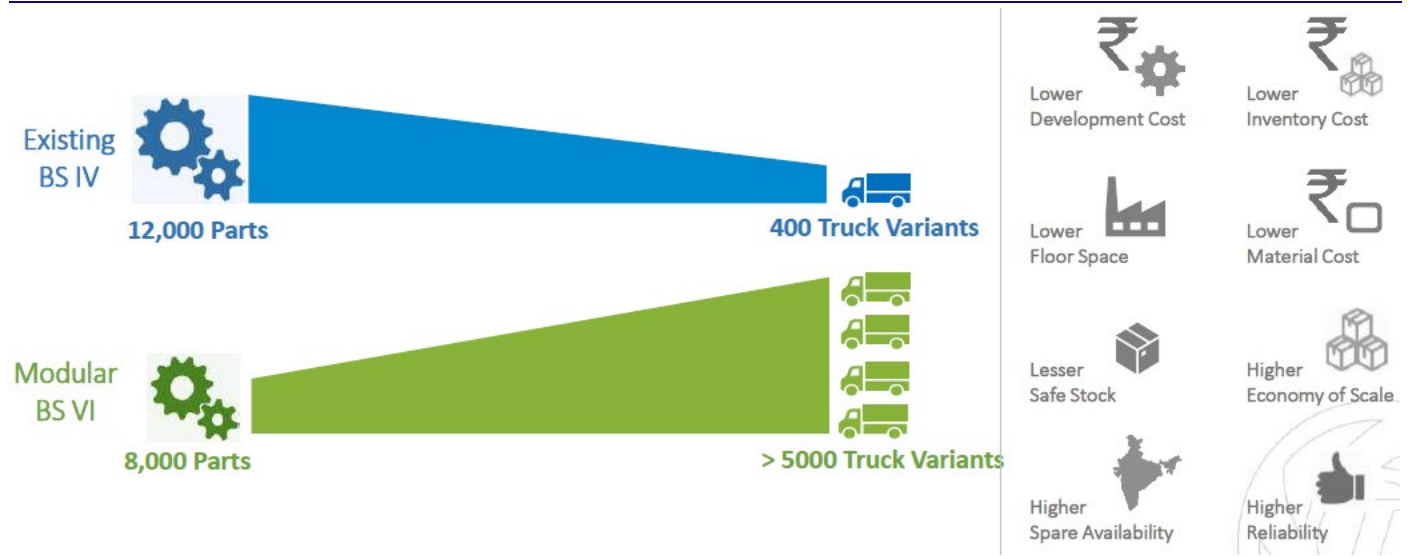


Source: Company

Exhibit 3: AL's differentiation in LCV business

Source: Company

Exhibit 4: Benefits of modular platform for AL



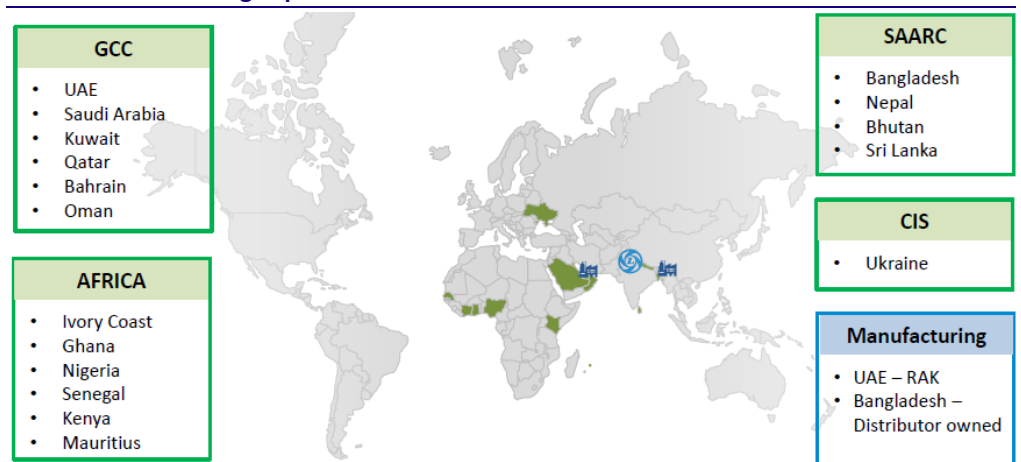
Source: Company

Exhibit 5: AL's exports product portfolio has material gaps currently, which would be addressed in near future

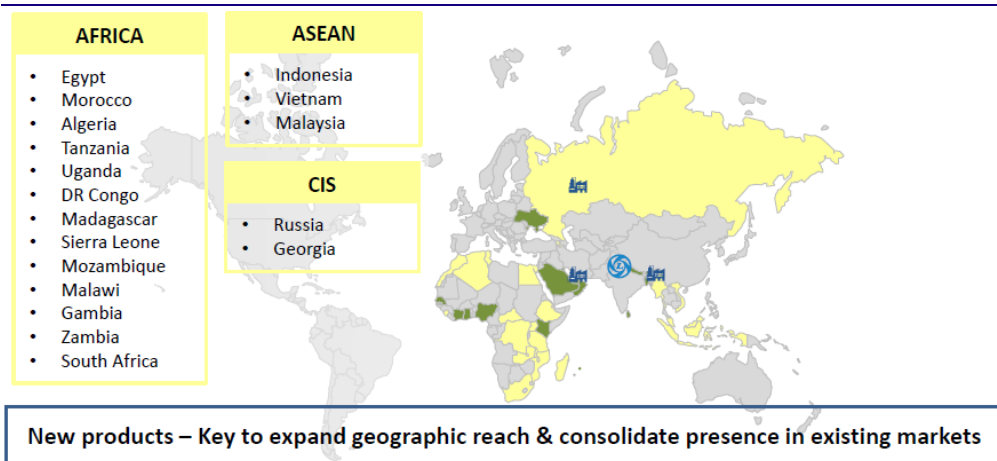


Source: Company

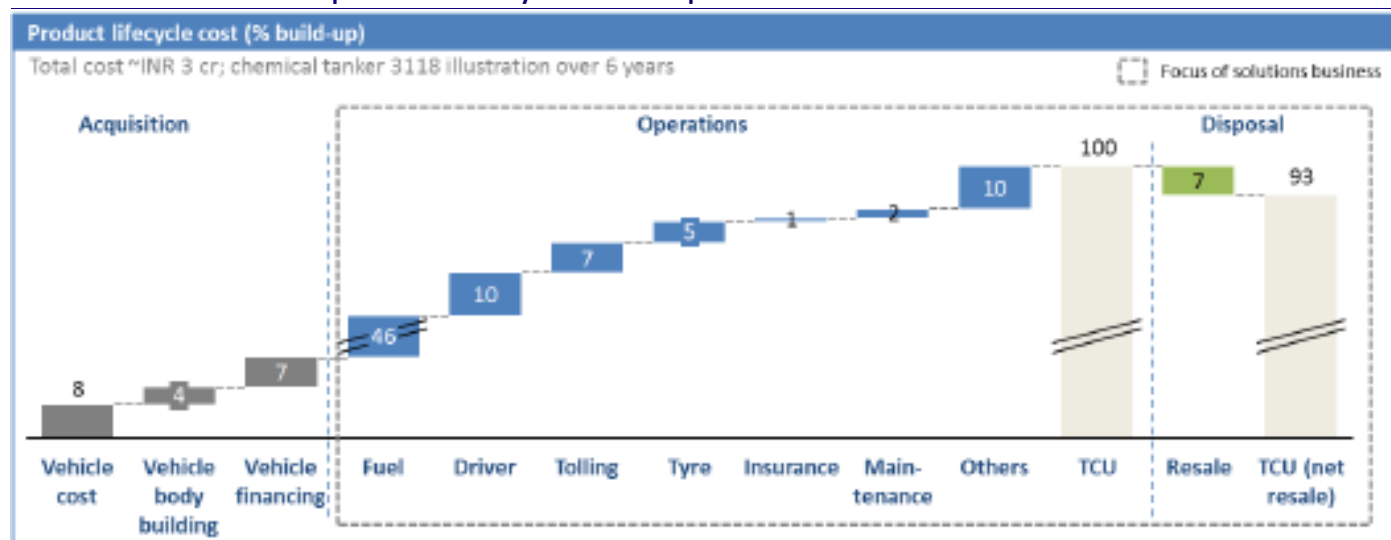
Exhibit 6: AL's existing export market...



Source: Company

Exhibit 7: ...but expanding market with product portfolio

Source: Company

Exhibit 8: AL's CSB aims to capture whole lifecycle relationship

Source: Company

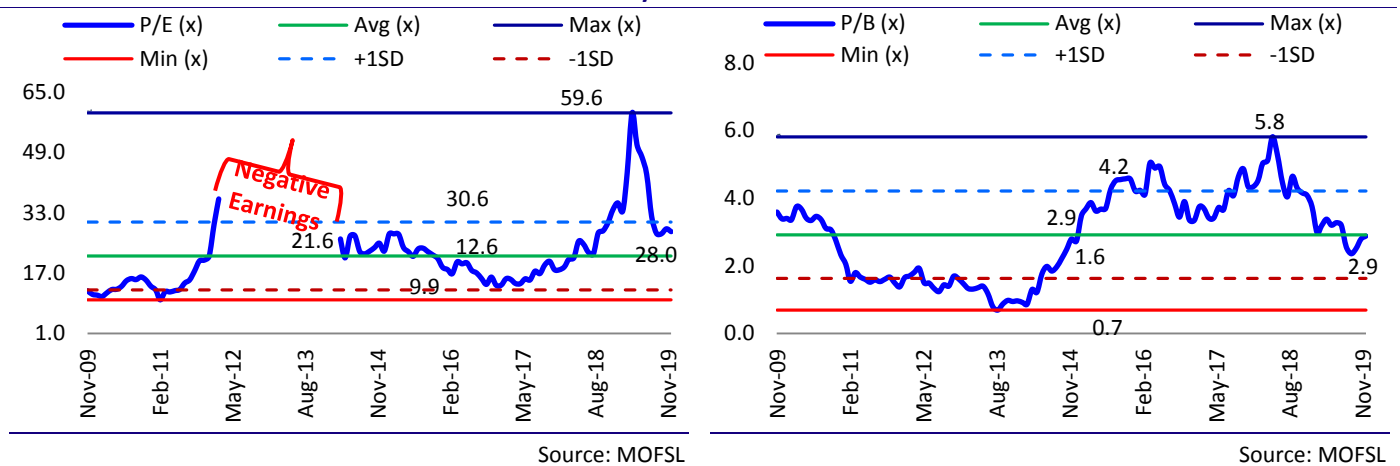
Valuation and view

- **Expect domestic M&HCV CAGR of 10% over FY20-22:** We expect CV demand to remain under pressure in FY20. However, on a low base of FY20, we estimate domestic M&HCV volume CAGR of ~10% over FY20-22, though FY22 volumes would still be ~25% lower than the peak of FY19. Mandatory scrapping of trucks (if announced) should benefit CV demand beyond FY20.
- **Focus on creating and expanding profit/revenue pools:** AL is focused on expanding/creating new revenue and profit pools. De-risking of the M&HCV business, along with expansion of the nascent businesses like spares (5% of sales), exports (7% of sales), LCV (8% sales) and defence (1% of sales), is the key focus area. Also, AL has set up a new business vertical – Customer Solution – to target a higher share of the customer wallet across lifecycle in areas like finance, spares and fuel.
- **Expect a sharp recovery from lows of FY20:** We expect revenue/EBITDA/PAT CAGR of 27%/51%/90% over FY20-22 on a very low base of FY20. Over the long term, AL's focus on expanding and creating new profit/revenue pools is likely to de-risk the business, with the share of domestic trucks in revenue likely to shrink

to 55-60% by FY22 (v/s 68% in FY19) and EBITDA margin at 10.5% (10.8% in FY19 and 6.9% in FY20). Despite such a good recovery, our EPS estimate for FY22 would be ~20% lower than the peak of FY19.

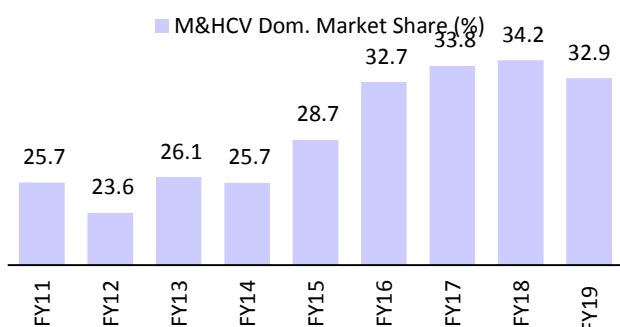
- **Valuation and view:** We cut our EPS estimate for FY20 by 24% to factor in weaker volumes in 2HFY20 and higher tax. However, we have raised our FY21 EPS estimate by ~3% as we upgrade our margin and depreciation estimates. Unlike in the previous cycles, AL is on a very strong footing (lean cost structure and net cash balance sheet) and focused on adding new revenue/profit pools. Valuations at ~22.7x FY21E EPS and ~11.5x EV/EBITDA are reasonable in view of early recovery cycle earnings. Maintain **Buy** with a TP of INR95 (10x Sep'21 EV/EBITDA + INR10/sh for HLF post 20% HoldCo discount).
- **Key risks:** (a) Risk to road share for freight movement from upcoming DFCC. (b) Intensifying competitive intensity resulting in a loss in market share and shrinking margins. (c) Any dilution in promoter's stance on separation of ownership and management.

Exhibit 9: Recent valuation contraction reflects uncertainty in demand



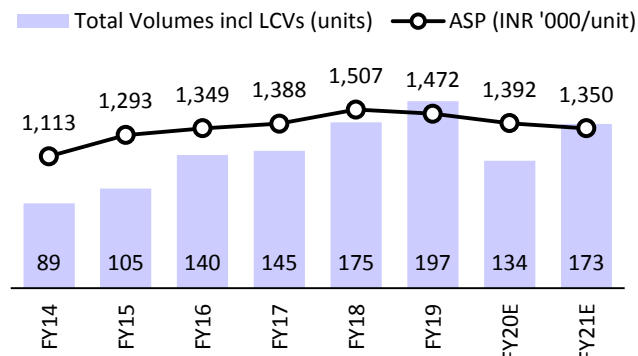
Ashok Leyland | Story in Charts: Better prepared for ongoing downcycle

Exhibit 10: AL's market share trend



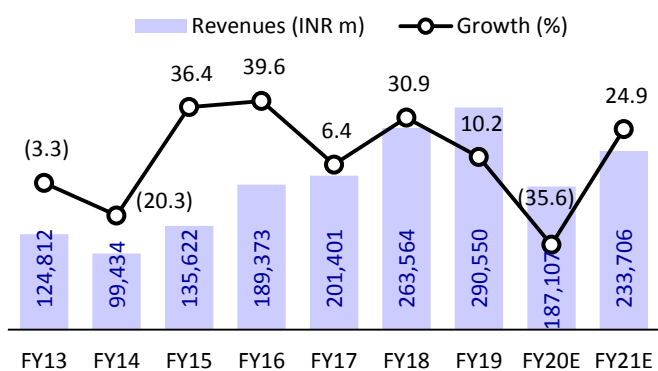
Source: Company, MOFSL

Exhibit 11: Volume and realization growth trend



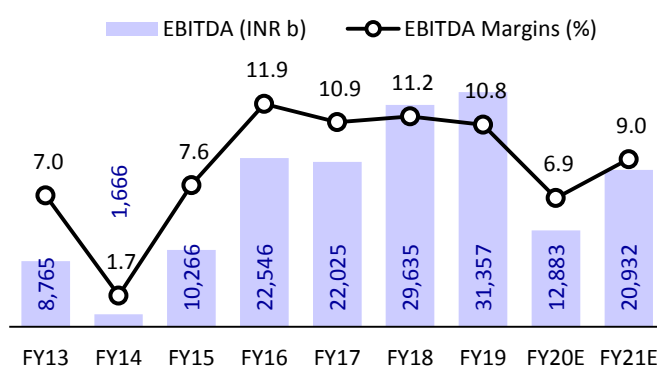
Source: Company, MOFSL

Exhibit 12: Revenue growth trend



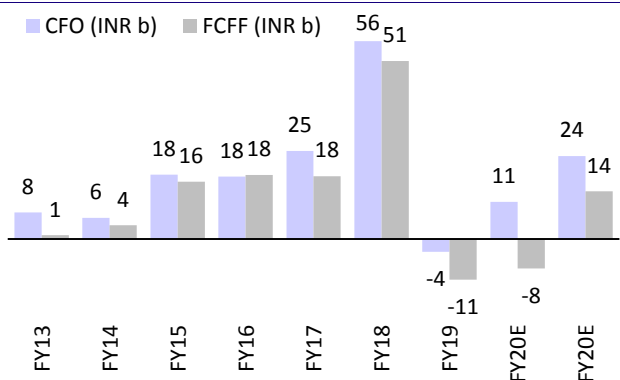
Source: Company, MOFSL

Exhibit 13: EBITDA and EBITDA margins trend



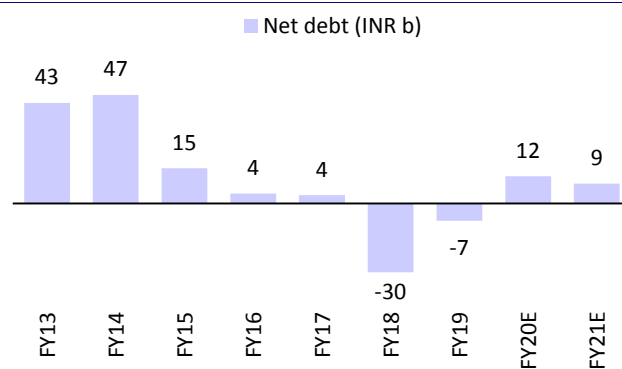
Source: Company, MOFSL

Exhibit 14: CFO and FCFF trend



Source: Company, MOFSL

Exhibit 15: AL turned net cash company



Source: Company, MOFSL

Key operating metrics

Exhibit 16: Snapshot of revenue model

000 units	FY14	FY15	FY16	FY17	FY18	FY19	FY20E	FY21E
HCV Passenger (units)	19	21	26	23	20	20	13	15
Growth (%)	-18.0	7.7	24.1	-12.1	-10.5	-1.7	-35.5	13.8
HCV Goods (units)	41	57	84	91	111	123	71	78
Growth (%)	-26.1	39.0	47.6	7.9	22.6	10.6	-42.3	10.0
LCVs (units)	29	27	31	32	43	55	51	80
Growth (%)	-47.0	306.0	-13.1	-89.3	4,784.6	40.8	-99.2	37,755.0
Total M&HCV volumes (units)	60	78	110	113	131	143	84	93
Growth (%)	-23.7	29.0	41.3	3.2	16.0	8.7	-41.3	10.6
Total Volumes incl LCVs (units)	89	105	140	145	175	197	134	173
Growth (%)	-22.1	17.4	33.8	3.4	20.5	12.9	-31.9	28.8
ASP (INR '000/unit)	1,113	1,293	1,349	1,388	1,507	1,472	1,392	1,350
Growth (%)	2.2	16.1	4.4	2.9	8.6	-2.3	-5.4	-3.0
Net Sales (INR b)	99	136	189	201	264	291	187	234
Growth (%)	-20.3	36.4	39.6	6.4	30.9	10.2	-35.6	24.9

Source: Company, MOFSL

Financials and Valuations

Income Statement					(INR Million)
Y/E March	2017	2018	2019	2020E	2021E
Volumes ('000 units)	145	175	197	134	173
Growth (%)	3.4	20.5	12.9	-31.9	28.8
Net Sales	201,401	263,564	290,550	187,107	233,706
Change (%)	6.4	30.9	10.2	-35.6	24.9
EBITDA	22,025	29,635	31,357	12,883	20,932
Change (%)	-2.3	34.6	5.8	-58.9	62.5
EBITDA Margins (%)	10.9	11.2	10.8	6.9	9.0
Depreciation	5,179	5,985	6,210	6,617	7,561
EBIT	16,846	23,650	25,147	6,266	13,371
Interest & Fin. Charges	1,554	1,473	704	856	1,052
Other Income	1,363	1,966	1,099	1,019	1,275
PBT	13,301	23,858	24,968	5,579	13,594
Tax	1,070	6,681	5,136	1,674	3,391
Effective Rate (%)	8.0	28.0	20.6	30.0	24.9
Rep. PAT	12,231	17,177	19,832	3,905	10,204
Change (%)	218.1	40.4	15.5	-80.3	161.3
% of Net Sales	218.1	40.4	15.5	-80.3	161.3
Adjusted PAT	15,457	17,359	20,268	4,500	10,204
Change (%)	101.8	12.3	16.8	-77.8	126.8

Balance Sheet					(INR Million)
Y/E March	2017	2018	2019	2020E	2021E
Sources of Funds					
Share Capital	2,846	2,927	2,936	2,936	2,936
Reserves	58,415	69,528	80,389	76,348	78,606
Net Worth	61,261	72,455	83,324	79,284	81,542
Loans	21,449	12,263	6,324	13,824	11,824
Deferred Tax Liability	1,269	2,986	2,497	2,776	3,456
Capital Employed	83,978	87,704	92,145	95,884	96,822
Application of Funds					
Gross Fixed Assets	59,807	64,798	71,437	88,013	101,013
Less: Depreciation	8,871	13,817	19,791	26,408	33,969
Net Fixed Assets	50,937	50,981	51,646	61,605	67,044
Capital WIP	2,059	4,226	6,576	8,000	5,000
Goodwill		4,499	4,499	4,499	4,499
Investments	28,789	56,067	26,365	28,365	29,865
Curr.Assets, L & Adv.	58,615	57,591	93,158	48,777	62,766
Inventory	26,310	17,583	26,847	7,689	19,209
Sundry Debtors	10,644	9,448	25,055	12,816	12,806
Cash & Bank Balances	9,120	10,422	13,736	2,129	3,219
Loans & Advances	12,542	20,138	27,520	26,144	27,532
Current Liab. & Prov.	56,421	85,660	90,099	55,363	72,353
Sundry Creditors	31,170	48,879	50,189	28,194	38,417
Other Liabilities	18,743	26,146	29,386	20,505	25,612
Provisions	6,509	10,635	10,524	6,664	8,324
Application of Funds	83,978	87,704	92,145	95,884	96,822

E: MOSL Estimates

Financials and Valuations

Ratios

Y/E March	2017	2018	2019	2020E	2021E
Basic (INR)					
EPS	5.4	5.9	6.9	1.5	3.5
EPS Fully Diluted	5.4	5.9	6.9	1.5	3.5
EPS Growth (%)	101.8	9.2	16.4	-77.8	126.8
Cash EPS	7.3	8.0	9.0	3.8	6.1
Book Value per Share	21.5	24.8	28.4	27.0	27.8
DPS	1.6	2.4	3.4	2.3	2.3
Payout (Excl. Div. Tax) %	28.7	41.0	49.4	146.8	64.7
Valuation (x)					
P/E	14.6	13.3	11.4	51.6	22.7
Cash P/E	10.9	9.9	8.8	20.9	13.1
EV/EBITDA	10.4	6.8	7.2	18.9	11.5
EV/Sales	1.1	0.8	0.8	1.3	1.0
Price to Book Value	3.7	3.2	2.8	2.9	2.8
Dividend Yield (%)	2.0	3.1	4.3	2.8	2.8
Profitability Ratios (%)					
ROE	26.8	26.0	26.0	5.5	12.7
RoCE	20.7	21.5	23.2	5.4	11.4
RoIC	36.4	55.8	64.0	8.5	17.3
Turnover Ratios					
Debtors (Days)	19	13	31	25	20
Inventory (Days)	48	24	34	15	30
Creditors (Days)	56	68	63	55	60
Working Capital (Days)	10	-30	2	-15	-10
Fixed-Asset Turnover (x)	4.0	5.2	5.6	3.0	3.5
Leverage Ratio					
Net Debt/Equity (x)	0.1	-0.4	-0.1	0.1	0.1

Cash flow Statement

(INR Million)

Y/E March	2017	2018	2019	2020E	2021E
OP/(Loss) before Tax	16,846	23,858	24,968	6,266	13,371
Int/Div Received	690	552	-413	1,019	1,275
Depreciation	5,179	5,546	6,210	6,617	7,561
Direct Taxes Paid	-3,476	-4,149	-5,603	-1,395	-2,711
(Inc)/Dec in Work Cap.	1,903	35,987	-29,638	-1,962	4,091
Other Items	3,914	-5,596	853	0	0
CF from Oper. Activity	25,056	56,198	-3,624	10,545	23,587
Extra-ordinary Items	-3,508	-253	-549	-849	0
CF after EO Items	21,548	55,945	-4,172	9,695	23,587
(Inc)/Dec in FA+CWIP	-3,660	-5,321	-7,315	-18,000	-10,000
Free Cash Flow	17,888	50,624	-11,487	-8,305	13,587
CF from Inv. Activity	-14,768	-33,321	23,115	-20,000	-11,500
Inc/(Dec) in Debt	-8,827	-12,700	-6,621	7,500	-2,000
Interest Rec./(Paid)	-1,638	-1,464	-1,029	-856	-1,052
Dividends Paid	-3,254	-5,495	-8,598	-7,946	-7,946
CF from Fin. Activity	-13,719	-19,613	-16,162	-1,302	-10,997
Inc/(Dec) in Cash	-6,939	3,011	2,781	-11,607	1,090
Add: Beginning Balance	17,352	10,412	13,423	16,205	4,598
Closing Balance	10,412	13,423	16,205	4,598	5,688

E: MOSL Estimates

NOTES

Explanation of Investment Rating	
Investment Rating	Expected return (over 12-month)
BUY	>=15%
SELL	< - 10%
NEUTRAL	< - 10 % to 15%
UNDER REVIEW	Rating may undergo a change
NOT RATED	We have forward looking estimates for the stock but we refrain from assigning recommendation

*In case the recommendation given by the Research Analyst is inconsistent with the investment rating legend for a continuous period of 30 days, the Research Analyst shall within following 30 days take appropriate measures to make the recommendation consistent with the investment rating legend.

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