

Ashok Leyland (AL IN)

Member of quant-based [HTI Portfolios](#): Value

Target Price **Rs95.00**
 Current Price **Rs140.9**
 % Downside **33%**

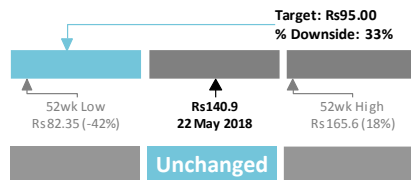
The Scoop: Q4 Disappoints, Multiple Cost Headwinds to Limit Margin Upside

Automobiles & Components

India

22 May 2018

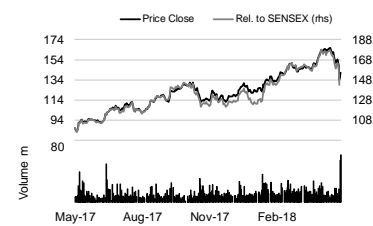
SELL



Basic Share Information

Market cap	Rs413.0b / US\$6.07b
Daily traded value (3mth)	US\$37.88m
Shares outstanding	2,931m
Free float	48.7%
Net debt-to-equity	-6.8%
1 yr high	Rs165.6
1 yr low	Rs82.35
Foreign Shareholding	23.3%

Price/Volume



Source: Bloomberg

	1mth	3mth	12mth
Absolute	-9.4%	6.5%	63.8%
Absolute USD	-12%	1.8%	55.4%
Relative to SENSEX	-10%	4.1%	50.6%



Aniket Mhatre

Haitong International Research Ltd
 aniket.mhatre@htisec.com



Anish Rankawat

Haitong International Research Ltd
 anish.rankawat@htisec.com

Hong Kong Office	(852) 2899 7090
Tokyo Office	(81) 3 3560 9300
London Office	(44) 20 7456 1140
New York Office	(1) 212 351 6050
Mumbai Office	(91) 22 4315 6839

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What event has happened?

Ashok Leyland's (AL IN; AL) Q4 FY3/18 EBITDA margin of 11.8% was below our estimate of 12.2% due to higher other expenses versus our expectations.

Why is it significant?

AL enjoyed multiple tailwinds in Q4 including: 1) strong 23% YoY volume growth over the high base of last year (+26% QoQ); 2) relatively lower discounts; 3) higher tonnage growth. Despite these benefits, its EBITDA margin improvement of just 70bps QoQ has been disappointing. Given that the medium and heavy commercial vehicle (MHCV) goods industry volume has grown at a healthy 19% YoY in FY3/18 and the tonnage growth has been much higher, we expect industry volume growth to remain in single digit in FY3/19 (we are factoring in 8% YoY volume growth for AL). Early signs of industry volume growth normalizing were visible in AL's April sales numbers and also in the resumption of overloading in some north Indian states (strict implementation of overloading ban was one of the key drivers of sharp volume growth in FY3/18). Apart from this, we believe AL faces multiple cost headwinds in the coming fiscal which include: 1) rising input cost pressure; 2) rising discounts led by competitive pressure, as Tata Motors (TTMT IN), the market leader in the segment, targets to recover its lost market share; 3) the merger of its relatively low-margin light commercial vehicle (LCV) business with itself from April 2018. On account of these factors, we expect AL's EBITDA margin to decline 80bps YoY in FY3/19 and later stabilize at 10% in FY3/20.

Implications for our earnings forecast?

On account of the sharp increase in volumes in H2 FY3/18, we raise our FY3/19 and FY3/20 NP for AL by 10% each.

How do valuations look now?

After a very strong earnings growth in FY3/18, we expect AL's NP growth to normalize to 8% CAGR over FY3/19–20, largely back-ended. Given a decelerating earnings growth trajectory, AL's current PER valuation of 22.3x FY3/20 appears expensive, for a company which remains exposed to cyclical volatility of the MCHV industry. On the back of our earnings upgrade, we raise our price target to Rs95 from Rs86 earlier. We value AL at a target PER of 15x applied to our FY3/20 EPS which is in line with its last seven years' one-year forward PER.

What is distinctive about our stock view?

Our estimates are well below Bloomberg consensus over FY3/19–20 as we believe rising cost pressure in a highly competitive environment would limit AL's EBITDA margin upside over our forecast period. A higher volume growth than we currently expect or a better margin than our forecasts are key upside risks to our estimates.

	Mar-16A	Mar-17A	Mar-18A	Mar-19E	Mar-20E	Trend
Total turnover (Rsm)	189,373	200,187	262,479	293,887	337,315	▬ ▬ ▬ ▬ ▬
Operating profit (Rsm)	17,667	16,846	21,844	21,943	26,471	▬ ▬ ▬ ▬ ▬
Pre-tax profit (Rsm)	8,265	13,301	22,307	22,530	26,619	▬ ▬ ▬ ▬ ▬
Net income to ord equity (Rsm)	3,896	12,231	15,626	15,658	18,500	▬ ▬ ▬ ▬ ▬
Adjusted net profit (Rsm)	11,998	11,659	15,748	15,658	18,500	▬ ▬ ▬ ▬ ▬
Net profit growth	16.4%	213.9%	27.8%	0.2%	18.2%	▬ ▬ ▬ ▬ ▬
P/E (x)	106.0	33.8	26.4	26.4	22.3	▬ ▬ ▬ ▬ ▬
Adj P/E (x)	34.42	35.42	26.22	26.37	22.32	▬ ▬ ▬ ▬ ▬
Adj EV/EBITDA (x)	11.72	10.14	2.69	3.67	3.43	▬ ▬ ▬ ▬ ▬
P/B (x)	7.42	6.55	5.76	5.22	4.70	▬ ▬ ▬ ▬ ▬
ROE	8.2%	21.2%	23.5%	20.8%	22.1%	▬ ▬ ▬ ▬ ▬
Dividend yield	0.8%	1.3%	2.0%	2.0%	2.3%	▬ ▬ ▬ ▬ ▬
EPS HTI old (Rs)	1.37	4.30	3.81	4.87	5.76	▬ ▬ ▬ ▬ ▬
EPS HTI New (Rs)	1.33	4.17	5.33	5.34	6.31	▬ ▬ ▬ ▬ ▬
Adj EPS (Rs)	4.09	3.98	5.37	5.34	6.31	▬ ▬ ▬ ▬ ▬
Consensus EPS (Rs)	3.63	4.36	5.13	6.53	8.17	▬ ▬ ▬ ▬ ▬
HTI EPS vs Consensus	(63.4%)	(4.3%)	3.8%	(18.2%)	(22.8%)	▬ ▬ ▬ ▬ ▬

Source: Company data, Bloomberg, HTI estimates

Click [here](#) to download the working model

AL has witnessed strong volume growth over a high base in Q4

Other expenses were up 30% QoQ and limited margin upside

EBITDA margin improvement at 70bps QoQ was disappointing given the volume growth

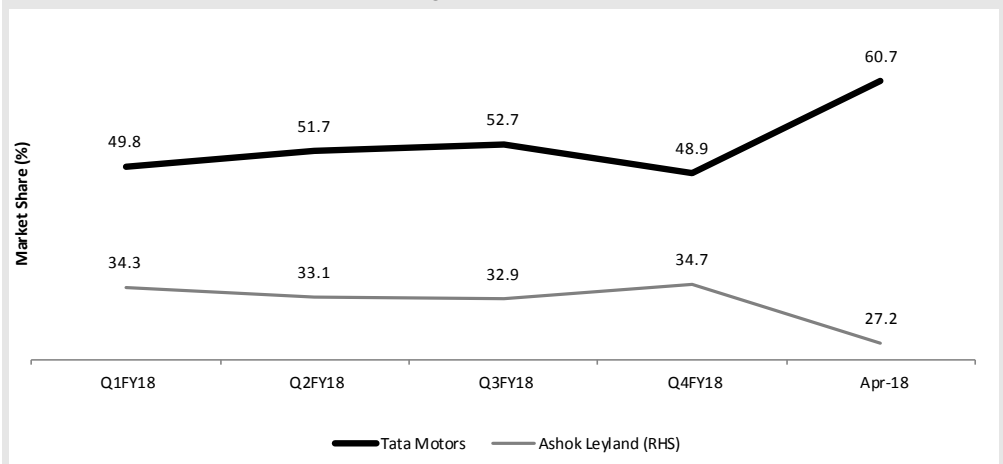
Competitive pressure continues to be high in the industry

QUARTERLY PERFORMANCE

INR Mn	FY17				FY18	
	3Q	4Q	1Q	2Q	3Q	4Q
Total Volumes (nos)	32,838	47,621	28,484	40,989	46,652	58,735
yoy growth (%)	6.2	8.2	-8.6	22.5	42.1	23.3
ASP (Mn INR)	1,375	1,390	1,488	1,475	1,525	1,494
yoy growth (%)	3.4	2.4	8.9	6.7	10.9	7.5
Net Sales	45,163	66,179	42,378	60,469	71,132	87,725
yoy growth (%)	9.8	10.8	-0.5	30.8	57.5	32.6
(Inc.)/Dec in stock	-6,592	-508	114	4,653	-8,731	20,906
Net Raw Materials	37,945	48,111	29,311	38,421	59,549	42,155
RM / Sales (%)	69.4	71.9	69.4	71.2	71.4	71.9
Staff Welfare	3,918	4,118	4,376	4,825	4,918	4,549
% of sales	8.7	6.2	10.3	8.0	6.9	5.2
Other exp.	5,351	7,158	5,516	6,452	7,512	9,788
% of Sales	11.8	10.8	13.0	10.7	10.6	11.2
Total Cost	40,622	58,880	39,317	54,351	63,247	77,398
EBITDA	4,541	7,299	3,061	6,118	7,884	10,327
EBITDA Margin (%)	10.1	11.0	7.2	10.1	11.1	11.8
yoy growth (%)	1.1	-6.8	-36.5	14.0	73.6	41.5
Non-Operating Income	258	404	384	557	380	577
Extraordinary Income	-637	-3,280	-152	-26	-2	59
Interest	453	423	366	410	335	201
EBIT	4,346	7,280	3,079	6,264	7,929	10,703
Less: Depreciation	1,313	1,395	1,321	1,411	1,350	1,463
PBT	2,395	2,605	1,605	4,827	6,576	9,299
Tax	778	-2,157	492	1,484	2,079	2,626
Effective Tax Rate (%)	32.5	-82.8	30.7	30.7	31.6	28.2
Rep. PAT	1,617	4,762	1,112	3,343	4,497	6,674
yoy growth (%)	NM	-438.2	-60.5	12.4	178.1	40.2
Adj. PAT (after extraordinary)	2,254	4,119	1,265	3,369	4,499	6,615
yoy growth (%)	2.3	-14.1	-45.5	15.8	99.6	60.6

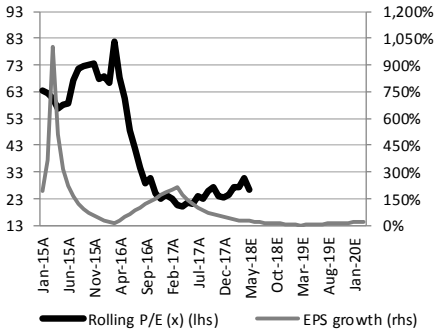
Source: Company data

Market Share In Domestic M&HCV Goods Segment



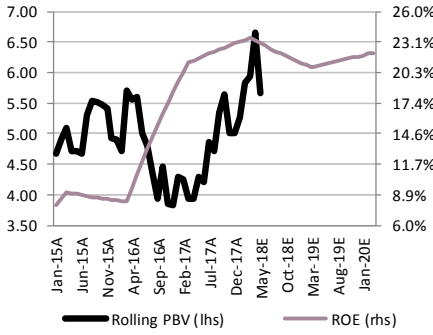
Source: SIAM

P/E (x) vs EPS Growth (%)



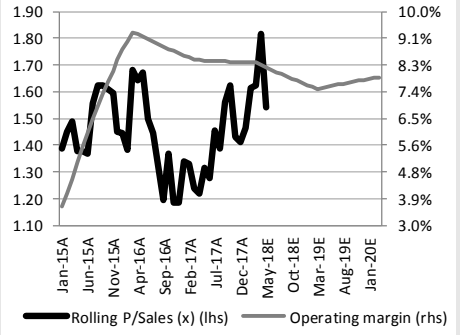
Source: Company data, Bloomberg, HTI estimates

P/B (x) vs ROE



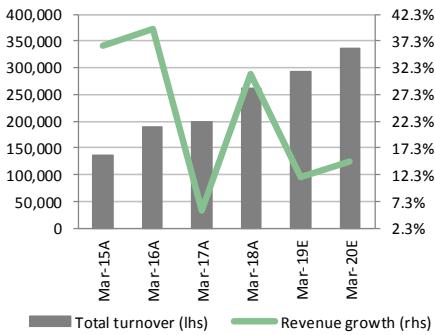
Source: Company data, Bloomberg, HTI estimates

PSR (x) vs OPM (%)



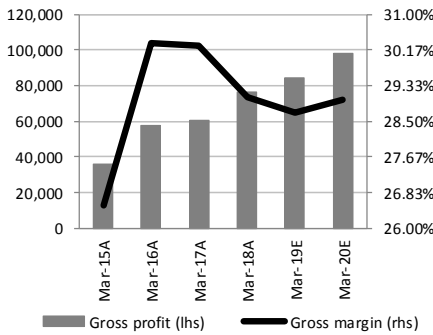
Source: Company data, Bloomberg, HTI estimates

Turnover and Growth



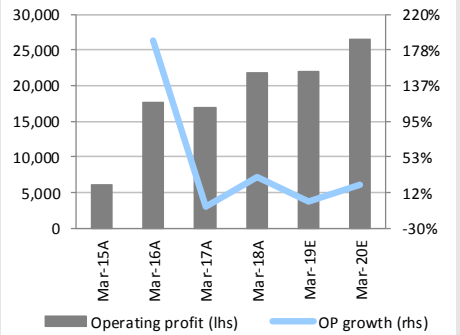
Source: Company data, Bloomberg, HTI estimates

Gross Profit and Margin



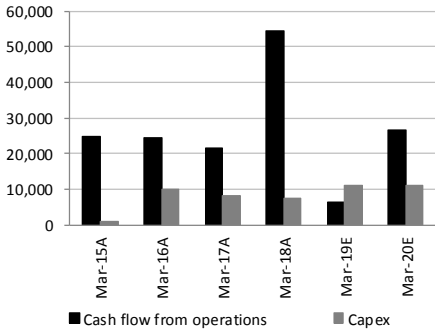
Source: Company data, Bloomberg, HTI estimates

Operating Profit and OP Growth



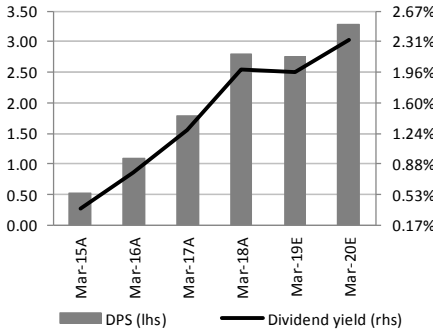
Source: Company data, Bloomberg, HTI estimates

CF from operations vs Capex (Rsm)



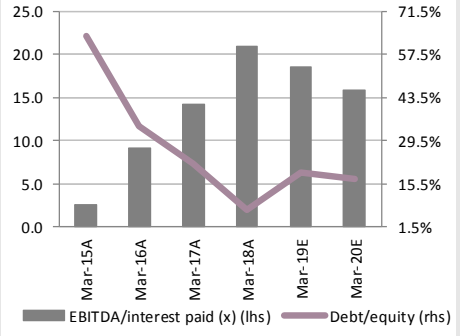
Source: Company data, Bloomberg, HTI estimates

Dividend Payout and Yield (Rs)



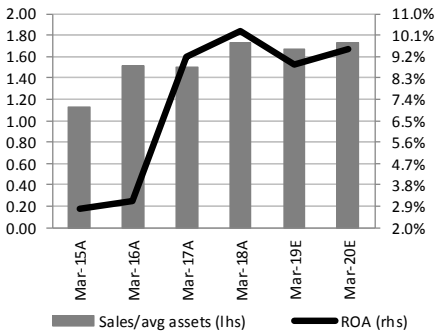
Source: Company data, Bloomberg, HTI estimates

Debt to Equity (%) and Interest Cover (x)



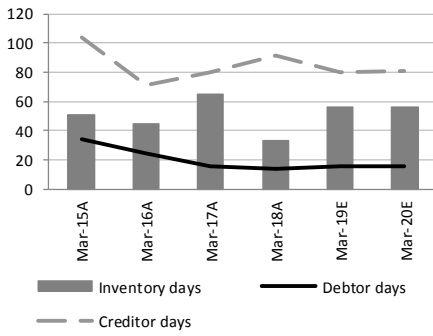
Source: Company data, Bloomberg, HTI estimates

ROA (%) and Asset Turnover (x)



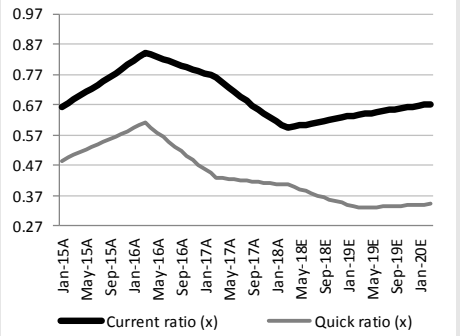
Source: Company data, Bloomberg, HTI estimates

Cash Operating Cycle



Source: Company data, Bloomberg, HTI estimates

Current Ratio (x) vs Quick Ratio (x)



Source: Company data, Bloomberg, HTI estimates

APPENDIX

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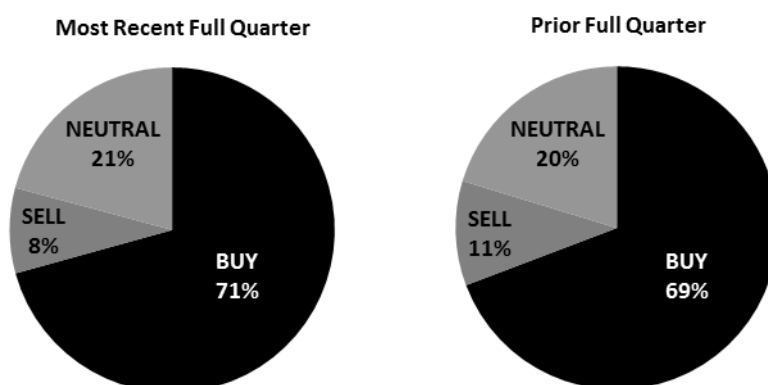
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Recommendation Chart



Date	Recommendation	Target (Rs)	Price (Rs)
2018-02-05	Sell	86.0	129.4
2017-09-08	Sell	76.0	115.2
2017-07-25	Sell	73.0	105.0
2017-06-28	Sell	72.0	92.2
2017-03-24	Sell	74.0	87.4

Source: Company data Bloomberg, HTI estimates

Definitions for Key Investment Metrics

Business Growth

This is the metric which matches the top line in our report.

Business profit

This is the metric which best represents operating profit in our report

Shareholder Returns

Return on Equity

Balance Sheet Risk

Net Debt to Equity