Ashok Leyland Post Q4 FY '18 Results Conference Call

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SPEAKERS: Mr. Vinod Dasari, CEO and MD;
Mr. Gopal Mahadevan, President Finance & CFO

Moderator: Good morning, ladies and gentlemen. I am Irshad, your moderator for the session. Thank you for standing by and welcome to Ashok Leyland Post Results Conference Call. For the duration of presentation, all participants' lines will be in listen-only mode. We will have a Q&A session after the presentation. I would like to now hand over the conference to Mr. Kapil Singh. Thank you and over to you, sir.

Kapil Singh: Hello everyone, good morning. Thanks for joining the call. Today from Ashok Leyland Management, we have Mr. Vinod Dasari, CEO and MD; and Mr. Gopal Mahadevan, President – Finance and CFO. I will hand over the call to Mr. Dasari for the opening remarks which will be followed by Q&A. Sir, over to you.

Vinod Dasari: Thank you very much. First, I would like to thank all who have joined us today and for the interest shown in Ashok Leyland. Welcome to the investor call. I am happy to say that we had another stellar quarter, continued our double digit operating margin run for now I think about 12 quarters out of previous 13 quarters and that is something that we intend to continue.

The industry also turned around very good. We had about 12% growth in overall volumes for the last full year. Although the initial quarters were smaller because of the BS-IV change in Q1 and Q2, it recovered very strongly. In the first quarter, TIV was 49,000 and then it went up all the way to 118,000. So, we maintained the market share. I think the demand will continue to grow. Our industry runs on three primary things. One is the GDP, which is being driven very well with the GST reforms and all that. Second is the growth in infrastructure. I think being a pre-election year, the continued investment in infrastructure will happen. And third is mining that is largely related to the infrastructure also. Plus, there has been a good shift for us particularly because of these two happenings in the country. One is more and more hub and spoke is happening maybe because of the GST phenomenon. And that is resulting in the size of truck becoming larger. So, even if our number of trucks does not go up, the size of truck goes up, so our revenue goes up. If I look at last quarter, our volume went up 15% for trucks and buses, but our revenue went up by 32%. So, it's an indication that the size of the trucks has become larger.

The year itself was quite satisfying. We were the only company in the world which launched the iEGR-based BSIV because we believe that it is a simpler thing to do for Indian markets and it is something where we continue to believe that you keep things simple and easy and that will help the reliability. The iEGR, people thought it would not work but we sold more than 100,000 trucks with that, and it has proven to be a very good technology developed in India.

I am going to be very positive about the benefits of it. We produced a record number of vehicles. If I look at the equivalent chassis, actually, we, produced even much higher than that. Revenues and profits were at record level. Some of the other positive factors last year are that we achieved the second Deming Award for our Hosur 2 plant. I believe we are now the only commercial vehicle company in the world with two Deming awards which is like a pinnacle of quality.

We had fantastic performance from our LCV business. We have been trying over the last three, four years that we have been talking to you, that we are trying to develop other businesses, so that we are not just depending on the truck business. I am happy that our LCV business has grown by about 37% over FY17. Our Defence business has grown very well. Now we are the second largest Defence private player to the Government of India. We have won about 12 tenders in the last year, and another 13 tenders a year before. Our after market is doing exceptionally well. We have grown at 30% per year for the last two or three years.

Our Power Solutions Business is also doing well. We have grown by about 14% over FY17 with very positive margins and we started to now export. For the first-time engines made in India are exported directly to the United States. That gives you confidence that we have capability of making engines for BSVI. So, we will be ready.

So, like that, all the non-truck businesses grew exceptionally well. Our international operations grew by about 36% over FY17 largely due to the very strong demand in many of our markets. We continue to maintain our position in the top 40 brands in India. For the first time in 20 years, our rating got upgraded to AA+. We had a fantastic turn-around of the LCV joint venture and as well as the Foundries joint venture which was for ages not making money and now it's quite profitable for us. Compared to it, we were some five, six years ago with about 6500 crores of debt, I am happy that we have a record cash of about 3000 crores in the bank now. We were rated by ET as one of the best places to work. And what gives me personally a lot of satisfaction is the CSR work that we are doing with lots of villages and schools, about 150 of them in Tamil Nadu alone. It has been rated as the best CSR activities in Asia.

So, as I look forward, I think last year was very pleasing in all round, not just in financial performance or market performance and various other aspects of it also, whether it was quality award or how we are judged as a company, as employer-employee relationship and so on.

Looking forward, I think I am quite bullish that the infrastructure-led demand will continue, the GDP will continue to grow on the back of GST, this hub and spoke model will continue to play to our favor, and I think the international markets will also continue to do well. Now we are at the same time looking at non-truck business also that I talked to you about. The after-market business for us is doing exceptionally well. We also launched digital platforms last year. For example, the service mandi platform where we said it was on-demand availability of mechanic anywhere on highway. We have launched it only on three highways across the country and we launched it last year and people thought that it would not work. By March, we had crossed 50,000 transactions. And I am happy to report that in April alone, we did 25,000 transactions. This is just one of the examples of the various initiatives that we are doing in after-market. So, we are growing our business a lot into services and solutions. We launched a new business called Customer Solutions Business.

All our domestic truck industry is continuing to do well. We are continuing to do well. But equally, we are looking at other aspects whether it's LCV, Defence, after-market, customer solutions, international areas to grow them at a faster pace than the truck business so that we can make our company less prone to cyclicality that the truck industry is known for.

Two things that I want to address that I know have been a concern for some of you or have been mentioned in the media. One was the high fuel price. Yes, that is a cause of concern, but we are hoping that it will not have an adverse impact on the MHCV industry. These things go up or down. Usually, it is adjusted in most of the contracts and it's not like if the price goes up the trucker does not get compensated. There are very few fixed contracts which are not negotiable, and I think that should have very little impact.

But, specifically, I wanted to mention about the impact of the overloading concern that some of you, media people also mentioned. Actually, it is happening only in a couple of pockets especially in UP and Rajasthan. In most states across the country, it is not happening. Those are not markets where we are the dominant players. But even if I look within that, it is happening in segments which are not the biggest for us. So, even if overloading happens, we did an internal calculation based on the total volume that we have, even with overloading at best it can have maybe 1% or 2% impact. That comes to about 1000 to 2000 vehicles maximum, which we will easily make up. So, I am not so worried about the overloading concern.

Some of you were also concerned on the commodity prices. I had mentioned that it will continue to increase its prices, but that is just a strategy. It is not a written down rule that we will increase prices. We will increase if necessary. Like I said, our goal is to protect our margin. We will not give away our margin for the sake of market share or for the sake of commodity increases. We continued to maintain our margins in double digits and we will continue to keep our margins going forward.

Last year, we were able to raise prices almost every quarter. In fact, in Q4, we raised prices twice, and yet we maintained market share throughout the year. So, that goes to show that we are the price leaders. So, we will probably raise prices on some of the innovative products that we have and it will allow us to get the premium pricing that we deserve. Otherwise, we won't be able to maintain the market share.

We are launching two very good product platforms this year, and I am very excited about it. There is a whole range of them. I think some of you have come and seen in our Global Dealer Conference / investor conference in Chennai. The two are the biggest. One is the high horsepower range of vehicles which are tippers and tractors. And second is the world's first 41-tonne with 5 axles with twin tyre lift. I wanted to say that our dealers are also doing very well. Almost all of them, we measure them on profitability, we take responsibility for their profitability. They are also doing very well. So, they are excited and enthused. I am quite bullish about not just this coming year, but the year after because of the BS-VI or Euro-VI. And then after that, there will be slight dip, but that would be made up by the scrappage scheme that is supposed to be coming in 2020.

Those are all the comments that I have. I am open to questions.

Moderator: Thank you very much, sir. Ladies and gentlemen, we are now open up for question and answer session. If you wish to ask a question, you may please "0" and "1" on your telephone keypad and wait for your name to be announced. We request the participants to restrict themselves to one or two questions at a time. If you have questions to be followed up, they can later come in the queue. Thank you.

The first question comes from Sahil Kedia. Please go ahead.

Sahil Kedia: Hi, this is Sahil from Bank of America. Sir, can you tell us, in terms of a) What is the kind of cost increase that you are likely to see on the BS-VI changeover? There seems to be numbers ranging from 6% to 10% in the various discussions that are happening? Number two, in your media interaction yesterday, you said that there is likely to be a pretty strong pre-buy that you are expecting. Can you give us some sense of what could be the impact on pre-buy the industry could get?

Vinod Dasari: The impact of Euro-VI on vehicle depends a lot on the type of the vehicle. So, I can't give you an exact number for the entire range of products that we make from 2.5-tonne to 49-tonne. But roughly (these are rough numbers), let's say a vehicle sells for Rs 20 lacs, an engine would cost about Rs 2 lacs at BS-IV levels. If you add some peripheries and all the peripheral equipment including intake systems and exhaust and cooling systems, it might cost a little bit more. But roughly, let's say about 10%. That Rs 2 lacs is likely to go up to Rs 3 to Rs 3.5 lacs. So, all in all, maybe Rs. 1 lac to Rs 1.5 lacs price increase per vehicle.

Sahil Kedia: There would be OBD etc. which would add on, or is that included in the cost that you have just said?

Vinod Dasari: OBD is already there for BS-IV. We will just have to upgrade that. So, it's more of a software change, not too much of an increase in that. We also own a company that make SCR systems. So, we are fairly confident of managing the cost as well as the quality of it.

As far as the other part of the question you asked about the pre-buy, because there is a cost increase from April 2020, now if the cost increase is Rs 1 to Rs 1.5 lacs, the price increase will be Rs 1.5 to Rs 2.0 lacs. So, it could be anywhere between 6% to 8% increase in overall pricing, depending on the model of course. Since there is a cost increase, most customers would like to pre-buy. This has happened in other parts of the world. It has happened in India also. I think it will also happen next year.

Sahil Kedia: One follow-up question, sir. In the auto expo, you have shown the swappable battery technology buses, how is that progressing and can you give some sense on how fast we can expect that to actually commercialize and start to sell?

Vinod Dasara: For our electric technology, as I have said, we are working on three different strategies. One was the fast charge. One was the swap. And another new technology that is coming up which is called flash. The swap is ready. We showcased it. We had targeted amongst this smart city campaign rather than go berserk at every city. We will take one city and do it well. So, we took the Ahmedabad contract. It is on cost per kilometer basis, and it allows us to try different types of technologies. So, 40-50 vehicles in Ahmedabad, we will have to start delivering in the next four to five months. We can deliver that. So, to answer your question, "When do we commercialize", I think in the next four to five months. Majority of that we will try with swap. We will also try other technologies in Ahmedabad.

Sahil Kedia: Alright, sir. Thank you. I will come back with few follow-up questions.

Moderator: Thank you very much, sir. Next we take the question from Sonal Gupta from UBS. Please go ahead.

Sonal Gupta: Good morning, sir. Thanks for taking my question. Sir, I just wanted to understand, in terms of like you said GST is clearly driving hub-and-spoke model and we have seen even this transformation happening. I mean like overall industry number, the share of above 25-tonne in terms of the SIAM data has really gone up a lot. So, over the medium term of next two, three years, what do you think should be the longer-term picture on this ratio proportion in terms of medium duty versus heavy duty and LCV? If you could give some light on that?

Vinod Dasari: If you look at all the developed countries, MHCV to LCV ratio is something between 70% to 80% LCV and balance MHCV. In ASEAN countries, it is closer to 80% LCV and in some of the larger countries it is closer to 70% LCV. So, we are somewhere following the same range of about 70% to 80% LCV.

Sonu Gupta: My question was more within the medium and heavy. How do you see the sort of split in terms of 9-tonne or lower end medim duty ICV versus heavy?

Vinod Dasari: Roughly, ICV is about 20% of the total MHCV TIV. I think that will continue to grow. Some of the 16-tonne segment will shift out. There has actually been a de-growth if you notice in that. And that de-growth has shifted to either 25-tonne or higher or to less than 16-tonne. So, in the long-run, I would believe that if you look at the number of vehicles alone, this might be about 60% to 70% large vehicles and 30% to 40% smaller vehicles, but we are a unique country in that sense because it is difficult to measure just in number of units. I remember when I joined Ashok Leyland, we used to make 4x2 vehicles and it was counted as one vehicle. Now you make 10x2 vehicle, it still counts as one vehicle although we sell it for almost 2.5 times the price. So, if you look in tonnage perspective, I would say that in MHCV 80% will be on the larger side, 80% to 90% on tonne kms will be on the larger side and maybe about 10% to 20% on tonne kilometers will be on the smaller side.

Sonu Gupta: That’s great. Sir, on the financial side, could I get breakups in this quarter in terms of revenues and percentage from the domestic trucks and other businesses that you give sometime?

Gopal Mahadevan: I will just give you a broad detail for the revenue share. For Q4FY18, domestic truck business accounted for about 70% and buses accounted roughly about 7%. Exports for the quarter was at about 5.5% but for the full year it was at about 8.6%.

Sonu Gupta: Right. Sir, could you just tell us how much was the after-market for the full year?

Gopal Mahadevan: We don't give the detailed breakdowns. After-market revenues was about 5% roughly.

Sonu Gupta: Okay, sir. Great. Thank you so much for answering my questions.

Moderator: Thank you very much, sir. Next in line we have Pramod Kumar from Goldman Sachs. Please go ahead. Pradmod, your line has been unmuted. Please go ahead.

We will take the next question which is coming from Amyn, Deutsche Bank. Please go ahead.

Amyn: Hi, thanks for the opportunity. Sir, my question is on the fact that you are guiding for robust growth this year and probably even higher growth next year. I just want to see in terms of capacity, what kind of a growth are you geared for in the next two years? Obviously, you have not made any new vehicle expansion. So, there is something that you are doing in the existing facilities. So, what kind of a capacity growth are you geared for in the next two years?

Vinod Dasari: First of all, in the LCV business, the capacity for us is largely defined by capacity constraints in the supply chain. Yes, there are some internal bottlenecks. So, let me put it down. As far as chasis assembly is concerned, there is very little concern for us. We can always go to the third shift and assemble. There were bottlenecks that we had in making, for example, 9-speed gearbox which we invested in last year, which cleared that capacity. We had capacity constraint in making cabins, especially in the paint shop. We did the investment in implementing the solution in May this year or first half of this month. So, that has resolved. There were some constraints on high horsepower engines on Neptune and others where we have done some de-bottlenecking and corrected those. So, we are looking at constraints aggregate by aggregate. Where there is a capacity constraint, we are releasing that. We do not see a requirement for a new plant to make chasis assembly. We do have some shortage in capacity in bus body that we projected if the bus body code comes and hence we are building a plant at Vijayawada. But those are very small investment plants which we have done in many parts of the world also. So, as for body building plants, we will continue to do in other parts of the world, but large truck plants we don't need to do. We will continue to invest in engines, gearbox, frame, etc. to release deeper bottlenecks.

Amyn: Okay. That helps. Secondly, in terms of market share, in the last few years when the industry was being a bit volatile, your market share was consistently increasing. But in the last two, three quarters when the industry growth has really picked up, your market share has been a bit volatile because I guess other players also are trying to get aggressive, trying to gain more market share in this growth. So, how would it play out for market share and margins over the next years wherein industry growth could be strong? But a lot of players who have lost out in the last three, four years may try to get more and more aggressive.

Vinod Dasari: It is a broader answer that I would like to give. We stick to our brand name which is "Aapki Jeet, Hamari Jeet". Our business is very simple. I must make my customer's profitability go up. In the end, the EMI of my customer is less than 10% of his operating cost. So, even if I sell a vehicle at a discount, the real impact that I make to his operating cost is negligible. I should focus on making vehicles which are best-in-class in operating cost. And hence, we do not like to go and try to buy market share. We will continue to focus on making sure that my customer is profitable, and thereby protect my margins at all times. I have said it repeatedly that we will not buy market share at the cost of margins. We will protect our margins. So, our focus then is to have the right kind of product that will deliver results to the customer, and then have a network that backs it up across the country.

Now, last year, the volatility in the market came because the north region grew by 20%, 25% which is where we have generally much lower market share. My competitors have a big market share. That was mostly because of rated load regime in UP. So, the market just took off in UP and some other places and moved the entire north zone to 20%. South zone did not grow at the same pace. It only grew at about 6% to 7%. Nevertheless, we maintained market share and grew in all regions. It will take us different effort, but I think so long as we are focused on three things: focus on the customer by providing him the right product; focus on the customer by making sure that that product is continuing to run no matter where it is; and third, do not chase market share, protect your margins. These are the things that we drive ourselves on.

Amyn: That was very helpful, sir. I will come back in the queue for more questions.

Moderator: Thank you very much, sir. Next in line we have Mr. Binay Singh from Morgan Stanley. Please go ahead.

Binay Singh: Hi, team. Thanks for the opportunity. Could you share some outlook on the bus segment and how do you see that going into FY19? Secondly, on the LCV we have seen pretty strong growth. You are talking about 10-12% growth in trucks. But how about the LCV growth, and what will that have an impact on the overall margin for the company?

Vinod Dasari: First of all, the bus segment de-grew last year substantially. And it de-grew in all segments. We will look at the three segments. One is the ICV segment, which is the school bus and staff segment. That is about half the business. And about 30% of this is inter-city buses which are large buses but inter-city. And then about 20% of the bus TIV is state transport. We purposefully slowly exited from many state transport businesses because of the difficulties. And we continue to gain market share in all of them except we lost where we purposely wanted to back out. But I expect the bus business to continue to come back. We are the fourth largest bus manufacturer worldwide. We are the largest heavy bus manufacturer in India. We are proud of that position, and we will continue to maintain that.

But regarding LCV, there is a growth of 21% in TIV largely driven by the hub-and-spoke that I talked about. We launched the Dost Plus last year. I am told it is the only commercial vehicle sold in the country with zero discount. That has helped us substantially enhance our margins. Gopal is saying that I cannot say the LCV margins specifically. But I can say that there are very good margins. I am very pleased by the turnaround that the LCV team has done. We have gained market share by 1.5%.

We are now looking into it. The Board has approved of an investment of around Rs 400 crores for the LCV business over the next three years. As the BS-VI platform comes, the entire range of LCV will be extended. But if you notice, we only have a 2.5-tonne vehicle and a 7-tonne with partner. So, we have large gaps. Plus the Dost cannot be made into LHD. So, we are only exporting the partner. So, we are now completely changing the platform. We will have a full range from 2-tonne to 7.5-tonne at multiple nodes and they will also be left-hand drive. So, capable and all will be BS-VI level capable. So, we are very excited about the investment that we are doing. And we wanted to see can the LCV business return is substantially higher than the cost and capital which they are able to do so. Hence, we went ahead with this investment.

Binay Singh: Right. That's very helpful, sir. And what will be the LCV contribution in FY17 in terms of revenues in FY18?

Gopal Mahadevan: LCV revenues overall contributed in FY18 roughly about close to 7%. And in FY17, it was about 6.3%.

Binay Singh: Great. Thanks. One additional question, on the competitive side, we have seen Ashok Leyland ticking prices up. But has the competition followed up on the same?

Vinod Dasari: I think there is a lag. Sooner or later, they will follow. Everybody's net sale realization last went up slowly but surely. Like I was saying we are the price leader. While somebody else said earlier. He asked a question. Those who are trying to do whatever at whatever cost trying to get market share back. So, they might not increase the price, but sooner or later they won't have a choice because the commodity price has gone up. We

increase prices every quarter. I think four or five times last year, and we still maintain the market share. So, we will have to balance between market share and margin. But if I have to, I will protect my margin first.

Binay Singh: Great. Thanks for that.

Vinod Dasari: But equally, I won't want to give up my market share. So, it's a nice balance.

Moderator: Thank you very much, sir.

Vinod Dasari: By the way, I will just add to that. From the managing director to the entry level executive, everybody has three metrics in this company, and the variable pay (performance bonus) of everybody is connected. It's market share. It's profitability. It's working capital. So, it's the balancing act of market share and margins and working capital that we have to do throughout the year, across the country, all the time. 100% of the variable pay is depending only on these three metrics for every single executive. So, it is the balancing act that we have to keep on doing. I will never say that one is more important than the other.

Given that there are others who are trying to only buy market share, I am not going to go and do that. It just means that I have to do more value selling. I have to go to the customer more, build a stronger relationship, explain my differentiation, enhance my network, those kind of things, rather than just give it away.

Moderator: Thank you very much, sir. Next in line, we have Mr. Pulkit Singhal from Motilal Oswal. Please go ahead.

Pulkit: Hi, from the Asset Management team. Sir, congrats on the good set of numbers. Just quickly, if I missed out on your guidance on the industry growth for FY19, if you can please repeat, for MHCV?

Vinod Dasari: I think it should be the same as last year. What I said is 10% growth.

Pulkit: Alright. And you expect the pre-buying to impact FY19 or only coming in FY20?

Vinod Dasari: FY20, later part of it.

Pulkit: Okay. And in terms of 4Q numbers, some of us have probably wrongly assumed that margins will be lot higher given that there was 23% growth quarter-on-quarter in terms of revenues. And since there are a lot of fixed cost in the business, we expected the operating leverage to be much higher than what you have shown. So, 11% has gone to 11.8% and other expenditure has gone up by 20% q-on-q. So, can you help us understand what really has happened this quarter and why it hasn't the operating leverage come as much as you would have expected?

Gopal Mahadevan: I think the operating leverage was satisfactory. If you look at it, there has been a 0.8% increase that has happened. Point number one. The second one is, we must understand that there is also a mix factor in this entire thing. When Vinod mentioned that the entire LCV business is profitable. What it actually means is that when you look at the three companies, which is the subsidiary and the LCV together. By the way, the Board has approved the merger with the main company. Those consolidated operations are profitable. But the LCV part of it, which is tucked inside… Ashok Leyland is at the moment possibly lower margin but once you get the merger out, you will see the benefit of the multiplied effect.

But having said that, when you have ICV in the truck, then you have STU billing happening in buses as well as when you have the LCV business growing also, you would actually see a little bit of the gross margin coming which is not anything to be worried about. It's purely a mix.

The other reason also has been that while there has been a certain amount of discounting that came off in January, February and March, actually we have seen the industry exerting a downward pressure on prices, and raw material prices also increased. So, you have a confluence of factors which actually increase the pressure on the EBITDA margin.

Having said that, when you look at the results as a whole and when you look at the larger expenditure growth, that actually does not reflect whether we are efficient or inefficient in controlling our overheads because other expenditure is a big mix of both variables and fixture expenses. If you look at it individually, sales

and manufacturing overhead… Let me tell you that we are almost at the same level if not that low in terms of percentage of revenue in the previous year.

Pulkit: Okay. The mix and pricing, etc. I thought we would understand raw material cost which it clearly reflects. But when it comes to other expenditure, if there is a 20% growth in volumes, this expenditure is likely to grow lesser because the variable cost will probably grow in line with the volumes but the fixed cost may not. So, is there an impact of mix even in other expenditure or what is it that that impacts us?

Gopal Mahadevan: There are expenditures which are incurred directly. For example, even for export, there are higher costs to be incurred on exports. Now, that will get factored into it. For example, you know the expenditure that you have to incur from brake to insurance because these are long haul revenues. So, that is the additional cost that comes in.

Similarly, what happens is when you look at some of the expenditures, lots of overheads are actually tugged in other expenditure because the lines you have with material cost, manpower, right? So, a whole bunch of expenditure sits on other expenditure.

The other thing that happens is you have some of the expenditure incentives, etc. which actually get rear-entered at the end of the year. Even though you try and accrue on a pro rata basis, what happens is some of the incentive payouts that happen in the fourth quarter. So, one of the things that we should remember when we are doing this is we really can't say that my revenue is going to grow by say 20% and then my percentage over raw material cost is say 25%. So, I just multiply and that will trickle down to the bottom-line, doesn't happen that way.

What we see internally, we look at it as to how much of the operating leverages kick in, and more importantly when we look at these four larger buckets which unfortunately is not how the format is for disclosure. If you look at the manufacturing overheads, selling overhead, administrative overhead and then manpower, we look at it as a percentage of revenue, how much is it getting better and we have our own internal target for

that. So, that is the reason why possibly when you look at it, you see this slightly lumpy growth in other expenditure.

Pulkit: Sure, sir. Lastly, EBITDA margins have been in double digit, I think, for the last 13 quarters now except for maybe one quarter.

Gopal Mahadevan: Right.

Pulkit: So, that is almost like given and well achieved kind of target. Now, from here on, given your expectations of industry growth and kind of market share increase, etc., from here on, are you in the mindset of increasing margins or are you more of protecting margins that you are currently looking at?

Gopal Mahadevan: Well, on a lighter vein, everybody likes to make money. So, we would certainly like to enhance margins. Like Vinod mentioned, we have to have an intelligent trade-off between volumes, market share and margins. So, you know, we have to ensure that we optimize these whole things so that we continue to enhance our presence in the country and the dealers get rewarded by the presence. So, we have to look at that also. At the same time, we have to ensure that we don't discount our way into buying market share and reducing margins. So, I think, we would certainly like to enhance margins. And let me tell you that this is not a forward-looking statement, but I think what the internal team is driving at is how do we get this operating leverage to work better. Right? But we have to do this ensuring that we don't cut cost which will enhance our capability and capacity.

So, there are investments that we have to make in people, in our training, in our marketing network, which we will not pull back on even if it's a bad quarter. What we have to look at is the capability building because a lot of what we are doing today, all the sheets which have been shown about three to four years ago, so that will continue in the journey. So, there are costs to be incurred. But is that going to depress our margins? The answer is no. The team is looking at how do we get an optimal mix and how do we get a mix between the domestic truck business, the bus and more importantly the after-market LCV, Defence and International. how do we keep continuously moving the mix better and

better to achieve a better gross margin which will also start trickling down even as we continue to focus on our operational efficiency.

Pulkit: Sure. Thank you. Just quickly a data point. FY18 domestic trucks and domestic buses, what would be the contribution? And defence, I don't think you mentioned about this and the contribution as well for FY18 full year.

Gopal Mahadevan: For FY18, overall domestic truck business was 66% and domestic bus business was 7.3% of the revenues. And Defence revenues accounted for nearly about 3%.

Pulkit: Okay, sir. Thank you. All the best.

Moderator: Thank you very much, sir. Ladies and gentlemen, before we move on to the next question, I would request the participants to please restrict them to a single question considering the paucity of time. We take the next question which is from Mr. Ashish Nigam from Axis Capital. Please go ahead.

Ashish Nigam: Thank you. On Defence and exports, can you highlight the growth we saw in FY18 and the outlook for FY19?

Vinod Dasari: Export was roughly 35% growth; and Defence, I think was 35% growth.

Ashish Nigam: Okay. On the longer-term outlook, what can we expect in FY19 and FY20 in both Defence and export?

Vinod Dasari: In Defence, it's a long gestation business, and we won 23 out of 27 tenders that we competed in. They will start to show up this year and beyond. This alone will contribute substantially to our revenue. There are more that we are working on. So, over the next five years, I think Defence will be more. These tenders that we have won alone could be about Rs 5000 crores in the next five years. I can't specifically tell you how much will be in Defence next year per se.

Gopal Mahadevan: And it depends on the ordering of the Government also.

Vinod Dasari: Yes. Defence budget, how much they order and so on. But the good point about Defence is… once you get it, it takes a long time to get. Once you get it, it stays for a long period of time, for about 15, 20 years. So, we are bullish about it because we used to only sell logistics vehicle. Now we are selling bullet-proof vehicles and some of those we are selling to Police also like J&K Police, Punjab Police have been our good customers on bullet-proof buses, and we also have mine-protected vehicles. We are exporting quite a few of these. So, our Defence business will continue to grow at this pace. This is what I expect.

Ashish Nigam: Okay. That's helpful. Also, on the cash for clunkers, what is the latest status? Is it mandatory for 20 years from FY20?

Vinod Dasari: Yeah, I think so. PMO has cleared it. I have been working on this for at least seven years now with various governments. There was always this problem of the guy who is actually using is not the same guy who is buying. So, we have suggested that we create a credible certificate like they used to be for the DEPB for exports. We even said that we will help contribute to some of that through an MRP discount if necessary to help incentivize the people to do that. It will happen from April 2020. I don't see any reason for it to happen anytime sooner. Anyway, the demand is very good right now. And I think that it's ideal that it comes in April 2020. First, I think it will come for 20 years, but I actually believe it will come from vehicles above 15 years. So, the number of vehicles that will be scrapped at 20 versus 15, it starts to go up at a rapid scale.

So, I think if you take the number of vehicles at 20 years and if my number is correct, it will be somewhere 200,000 to 250,000 which will be scrapped. But if you go to 15 years, it is like 600,000 or 700,000 or something like that.

Ashish Nigam: This is the vehicle population or the vehicles you expect to be scrapped.

Vinod Dasari: Vehicles that are expected to be scrapped.

Ashish Nigam: Okay.

Vinod Dasari: Just 20 years alone is equal to almost one full year of TIV demand or at least 70% of it. One year of Total Industry Volume is 350,000. 220,000 to 250,000

vehicles are scrapped or replaced. That is a huge demand. I don't think it will all come in one year. But I also think the government, by the way, will push for 15 years, not 20 years.

Ashish Nigam: And the incentive share between you and the government?

Vinod Dasari: Very little from us. It will be an MRP discount that we talked about.

Ashish Nigam: Sure. Just one last housekeeping question. Gopal, just give us the gross and the net debt number as on FY18?

Moderator: Mr. Ashish, may I request you to please join in the queue because the rest of the participants are waiting to ask questions?

Gopal Mahadevan: Our net debt is 2988 crores. That is cash positive. Let me clarify that.

Moderator: Thank you very much, sir. We have next Mr. Dinesh from Motilal Oswal Securities. Please go ahead.

Dinesh: Hi, sir. My question pertains to the LCV business. So, you have indicated that you would be spending a range from 2 tonne to 7 tonne. Any timeline like when we expect this product portfolio expansion to happen?

Vinod Dasari: From April 2020 predominantly. We are not wanting to launch new product and then upgrade it to BS-VI, but we will do the work right now and then we will launch the full range from 2020. But meanwhile, the existing product range will keep on upgraded.

Dinesh: Okay. So, till April 2020, we will have 2-tonne range and then we will expand to BS-VI?

Vinod Dasari: Yes. Let me clarify again. The entire range of vehicles that we have today are under license from our joint venture partner. Right? We are developing our range which will take us between 2.5 tonne to 5.5 tonne and then beyond also. This all will come with BS-VI.

Dinesh: Understood. Right. And LCV business subsidiaries which we are merging, what kind of debt it will add and what's the accumulated loss which will be eligible for tax rebate for us?

Gopal Mahadevan: Well, the overall LCV is quite insignificant at the moment. I think it's about Rs 220 crores. I will not be able to disclose the accumulated losses and tax rebates at this point of time.

Moderator: Thank you very much, sir. We will take the next question, which is from Ramesh Jain from IFL Wealth. Please go ahead.

Ramesh Jain: On the LCV part again, the profitability of the segment would be at par with the overall margins?

Gopal Mahadevan: Yes.

Ramesh Jain: Do we expect that to improve with the kind of growth that we are seeing?

Vinod Dasari: Well, that's the target to continue to improve. Look at it this way. I think last year, their margins substantially improved, and they had Dost+ only for half of the year. Now they will have Dost+ for the full year, and they will be able to compete much better. They have actually gained market share. Despite having only one Dost platform, we have now created Dost Plus as well as Dost Light. We created Dost Express and Dost CNG. So, we have multiple varieties of Dost and that has helped the margins.

Ramesh Jain: And even for that matter, the exports and spare parts without a replacement market, business will be materially higher margins as compared to the core business, right?

Vinod Dasari: Yes.

Ramesh Jain: And that kind of a growth that we are seeing in this segment, would you be using the better margins from these segments to protect… What would be your strategy in order the conserve the margins at current level or to gain perception discounting on the truck side and retain market share?

Vinod Dasari: I think you figure out my strategy. I can't say that on a public conference call as to what is my strategy to compete. But, as you know, the margins on vehicles

will always be tight. We will continue to sell value which is how good is our vehicle in terms of performance and how good is service network. We will focus on the customer profitability and not just the priced competitiveness at the OE level. Remember, I said for my customer less than 10% of the operating cost of the vehicle is EMI. So, just by giving him another Rs. 20,000 discount doesn't get him to make a significant dent. It might cater to his expectation, but it won't immediately enhance operating profit. But if I can give him 0.1 KMPL better, he will recover that in one month. That is what we focus on.

If you look at the percentage penetration that we have in spare parts, it is probably twice some of our nearest competitors have. So, we use the AMCs (Annual Maintenance Contracts) to help the profitability of our dealers. We use our spare parts and other sales to help the profitability of Ashok Leyland. We enhance with things like Service Mandi to capture the post sale revenue of our customers. Also, created a new business cost of Customer Solutions Business. I said all of these. So, you can see the strategy. I don't want to be articulating exactly what I will do with profits and how I will compete. But that's broadly the game.

Moderator: Thank you very much, sir. We take the next question which is from Mr. Chirag Shah from Edelweiss. Please go ahead.

Chirag Shah: Thanks for the opportunity. Sir, one question on 4123 or 41-tonne, when can we expect the launch and how are you looking in term of ramping it up?

Vinod Dasari: It is under trial right now. I hope to launch it in the second quarter.

Chirag Shah: Significant volumes from there would be in FY19?

Vinod Dasari: No. It will be a very good volume. Second quarter, not second half.

Chirag Shah: Okay, second quarter. And just a follow-up on electric buses, in the next one or two years, what kind of volume one can expect from industry perspective to happen from electric buses?

Vinod Dasari: Good question, Chirag. I think we talk a lot about electric vehicles but percentage of vehicles that will be electric in the next one or two years will still be insignificant.

Chirag Shah: Can we expect like 50 to 100 buses from industry perspective of month kind of order flow coming in? Is it driven by government entity only for the next two years? Is it the right way of looking at it? Private participation?

Vinod Dasari: Yes. Both of those assumptions are correct, Chirag.

Chirag Shah: Sir, it's the last question, if I can just squeeze in, just a housekeeping. On the discounting front, have the discounts gone down in Q4 on average basis?

Vinod Dasari: Yeah, I think so.

Chirag Shah: Is it possible to quantify? How much? Would the discount sequentially come down by Rs. 30,000 – 40,000 because we are getting mixed reviews that discounts have again inched up in the system?

Vinod Dasari: No, I would say that discounts have sequentially come down. In February, March, if I look at the margins, our margins are better.

Chirag Shah: Thank you. Fair point. This was really helpful. And all the best.

Moderator: Thank you very much. We take a follow-up question from Mr. Pramod from Goldman Sachs. Please go ahead. Mr. Pramod, your line has been unmuted.

Alright. Ladies and gentlemen, we take a follow-up question which has again come from Mr. Chirag Shah of Edelweiss. Please go ahead.

Chirag Shah: Thanks for the opportunity again. Just a follow-up on raw materials, can we assume our last part of the pressure is there for us in the quarter or how to look at the RM basket?

Vinod Dasari: Well, it is largely driven by steel and it is somehow protected by the government because of this MIP (Minimum Imported Price) that they have. In the end, in a truck which is 8 tonnes of weight, steel forms a major portion. So, that is going up. We will recover that much from the pricing. We have some cost reduction ideas as well. Last year also, there was commodity price increase, and we were able to recover all of that either through price increase or through cost reduction. I am fairly confident that we will do that again this year.

Chirag Shah: Fair point, sir.

Moderator: Thank you very much. Ladies and gentlemen, due to the paucity of time, we will take the last question which is coming up from Kapil. Please go ahead.

Kapil Singh: Sir, I had a couple of questions. Firstly, I wanted to check on the performance of Foundry business and how it has improved performance over the last year.

Vinod Dasari: Historically, as you know, last it was making negative EBITDA. Full year, we finished with a positive EBITDA, I think about 5% or so. Full year, cash break-even also. So, last several months, we have had positive EBITDA and it may continue. So, it's turnaround.

Kapil Singh: So, are you expecting to improve further?

Vinod Dasari: Yeah, I think so. The Foundry is one of the bad boys who are increasing prices.

Kapil Singh: Second, on the cash flow generation, Gopal, we had pretty strong cash flow generation in FY18. So, can you just run us through how we were able to achieve that, and what are you looking at for?

Gopal Mahadevan: Well, I will not be able to share prediction for next year because we don't give a guidance on either profitability or key financial matters. But two of the key reasons are – One is the level of profits has actually trickled down in the cash. Very quickly, our overall EBITDA has been pretty consistent. So, we have nearly about three years of very good profitability. So, we have been over 10% in EBITDA. So, that has actually come.

We have also been steadily improving our working capital. That is another key reason. Our CapEx over the last few years has been very negligible. So, all of these have resulted in cash generation. But what I would also want to say is that as on 31st of March, because of the pretty heavy demand, our levels of inventory have come down. And we had quite a bit of significant customer advances. So, the favorable cash that we had was about 2992 crores after a debt of roughly about 900 to 950 crores being set of. But one can't expect that all of that will continue to sit through the whole year. But all I can tell you folks is that the current financial position of the company is very, very strong. We have sufficient levers to fund our CapEx over the next few quarters. There are no major losses in subsidiaries. So, we have provided for it. So, the balance sheet is very strong at the moment.

Kapil Singh: Sir, what has been the pricing action that we have taken in the last few months after March?

Gopal Mahadevan: The last few months, we have taken a 2% increase in April.

Kapil Singh: This 2% would largely cover the material costing?

Gopal Mahadevan: Yeah, it would but the material cost increase is something that we are closely watching. Let us see what happen. Hopefully at some point in time, we will see some respite.

Kapil Singh: Okay, sir. Thanks.

Moderator: Thank you very much, sir. At this time, we would like to hand over the floor back to our speakers for final remarks.

Kapil Singh: Thanks everyone for joining the call. And I would also thank the Ashok Leyland management for taking out time for this one. You may all disconnect now. Thanks.

Moderator: Thank you very much, our speakers. Thank you so much, participants. Thank you for joining the call with us. Now you may disconnect your lines. Have a great day ahead. Thank you.