"Ashok Leyland Q1 FY15 Results Conference Call"

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MODERATOR: MR. MIHIR JHAVERI – ANALYST, RELIGARE CAPITAL MARKETS

Moderator: Ladies and gentlemen, good day and welcome to the Ashok Leyland Q1 FY15 results conference call hosted by Religare Capital Markets. As a remainder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Mihir Jhaveri from Religare Capital Markets. Thank you and over to you sir.

Mihir Jhaveri: Thank you Karuna. Good morning, ladies and gentlemen. On behalf of Religare Capital Markets Limited, I welcome you all for the Q1 FY15 results conference call of Ashok Leyland. We have with us today from the management Mr. Gopal Mahadevan – CFO. With this, I hand over the call to Mr. Mahadevan for opening remarks. Over to you sir.

Gopal Mahadevan: Thank you Mihir. Good morning everyone. Thank you very much for the interest in Ashok Leyland. Along with me, I have got Mr. K. M. Balaji, my colleague who handles Investor Relations and also the MIS and budgeting and working with him is T. S. Vijay Sarthy. I am going to keep this introduction very brief because I am sure that all of you would have multiple questions and I do not want to eat into your time given that we have an hour on this call.

The overall sales that 2,478 has increased 4.8% quarter-on-quarter and our market share for the M&HCV business is 25.5% as opposed to 23.2% last year. What I would like to bring to highlight is that despite of 4.8% growth, our EBITDA for the quarter is 4.7% as against 1% EBITDA in the same quarter last year. So while the growth in sales in a declining market, Ashok Leyland had been able to post a growth of about 5% in a declining market. Our EBITDA has relatively increased to 4.7% as against 1%. Our loss before tax is down by 58% to 70.45 crores and our loss after tax is down by 66% in Q1 last year at 47.95 crores. Our overall borrowing levels have also been coming down and as I talked to you in the month of July, our current debt levels are about 4,500 crores after the recent QIP that we have done. Our debt-to-equity excluding bills discounting is somewhere in the range of about 1.18 times excluding revaluation reserve. So if we were to look at the industry performance, the M&HCV volumes for the industry have declined in Q1 over the previous year, but what we believe we will see actually move forward into Q2 and possibly the later half of the year is little hardening up of volumes as economy starts to recover because the general indication that we have is that especially in the second half, we would see some recovery in the economic cycle in India. If that happens, there is no reason why the commercial vehicle industry should also not sympathetically follow. The share of South in the overall TIV is at about 24% which is at the same level as last year, but the most important thing is that we have actually seen the recovery of South cycles which was at a low of 18% in Q3 last year and then it went up to about 21% in Q 4. and finally have caught up to 24% which is also being a positive effect for Leyland.

From the Leyland perspective if were to look at it in almost all markets be it in South, North, East or Central, we have either been able to maintain the market share or increasing it. So that has also been a resultant of the 5% growth that we have seen and more importantly in terms of mix, we have actually have tipper and tractor sales growing by almost 51% quarter-on-quarter. So overall if you look at it, I think the company pursues its intention of reducing operating cost which has been witnessed by the improvement in EBITDA, the reduction in profit before tax as well as the loss before tax and the loss after tax. So I am not going to take up more time. I am going to hand it over to you folks for asking questions and clarifications please.

Moderator: Thank you very much sir. Ladies and gentlemen, we will now begin the question and answer session. First question is from the line of Yashesh Mukhi from Morgan Stanley. Please go ahead.

Yashesh Mukhi: Sir, I wanted to know what revenues from the non-vehicular business has been for this quarter and how that has moved versus the last quarter and Q1 of FY14?

Gopal Mahadevan: I think, see our revenues from non-vehicle that is the truck as what we do is instead of non-vehicle what we say is that if we look at our truck and bus business, M&HCV let us put it that way has accounted for roughly about 75% as opposed to about 78% for the same quarter in previous financial year.

Yashesh Mukhi: And sir would you be able to break down the non-vehicular revenues for us in terms of what is coming from where?

Gopal Mahadevan: No, actually we do not give that kind of a breakdown. The only thing that I would possibly share with you in this quarter has been that in terms of exports in volume terms, our volume has grown by about 8% and in revenue terms is about 12%. That is in line with the strategic direction that the company is trying to achieve. Of course one quarter is not an ample proof for it, but very clearly we are looking at actually diversifying the exports further so that it actually acts like a contra cyclical to the traditional trucking business in India.

Yashesh Mukhi: Right. Sir my second question was just on how discounts have moved over the quarter?

Gopal Mahadevan: See I would put it this way; we do not actually look at discounting as an absolute amount. What we focus on is whether the net realizations have been increasing and Ashok Leyland possibly has been one of the manufacturers who have actually been consistently raising prices. So if you were to look at it, on a quarter-on-quarter basis I think from Q3 of last year we have actually seen an improvement in realizations. So if you look at the reason for our current quarter performance, also the reasons have been that we have been able to improve our margins because of the mix, the second one has been because of the improvement in realizations and of course the third one has been on the focus on the operating cost. These are three very clear reasons why our margins have improved. So in the current quarter as well what we have been able to do aside of the positive mix that we have had, we have actually been able to improve our net realization by about 100 to 150 basis points.

Yashesh Mukhi: Right. Sir what was the price hike taken during the quarter?

Gopal Mahadevan: In the current quarter we have done it for various products at various times, but the price hikes typically have been about one quarter to one and a half percent.

Moderator: Thank you. The next question is from the line of Raghunandan from Quant Capital. Please go ahead.

Raghunandan: Could you throw some light on how you expect directionally speaking the performance of South to be and what are the triggers in the Southern region. And secondly with reference to the mix within M&HCVs, the higher tonnage vehicles are seeing good growth outperforming the rest of the segments. So how do you see the trend going forward there?

Gopal Mahadevan: Yes. Like I mentioned in my initial introduction, we have actually seen a bit of recovery on South and that has been important because South was possibly the most affected in the last possibly three quarters excluding the current quarter when we saw that the volumes were coming down. I think we would see some more positive traction that is an expectation from us at the moment. I would not want to give something extremely forward looking, but the expectation is that the South markets may recover even further on the back of some of the infrastructure work and the mining that may be opened up. And consequently we are also saying that tipper and tractor volumes going up. So for us if you really look at it, we believe that there is an opportunity for the tipper and tractor volumes to go up even further and the Southern markets to open up, but let us wait and watch.

Raghunandan: Sure sir. My query was what is driving this growth for this tippers and tractors?

Gopal Mahadevan: See, today what is happening is some of the larger players are ordering tippers and tractors based on the estimate that they are making on the revival of the economy. That is a lot of possible infrastructure related activities that the government is planning both at the state and the central level. So that is the reason why we are seeing a demand pull. The second thing that we must remember is that over the last possibly 2-3 quarters, take the current one, we have actually seen that the demand had fallen off quite significantly and so you are also seeing that what happened till possibly the quarter of December, we did see some revival happening in the fourth quarter of last year as well that is getting kind of reinstated.

Raghunandan: Thank you sir. You have shown a very strong margin performance compared to that of last year. So just wanted to understand like when will this convert into a positive PBT, your thoughts on that sir.

Gopal Mahadevan: Well, I will leave out the last bit of it, but all I can tell you is that Vinod and I have been communicating with the investing community. I think the focus of the company had been 3-4 things. One has been to improve the product mix as much as we can within the overall constraint of demand. The second one was also to see how we can consistently improve realizations which we have been doing from September of last year. We are possibly the only player who has been consistently raising prices about 1-1.5%, 2% price increases that have happened in Q3 of last year. We did the same thing in January, we did the same thing even in the later part of Q4 of last year especially in March and we did that again in the current quarter . We have raised prices over models regularly. This is also to ensure that the net realizations at the company level improved because sometimes you have to pass way larger discounts, but then for us at Ashok Leyland what we look at is very clearly the impact of net realization not just at discounts alone. So this was the second part. One was the mix, the second one was the realizations. The third one was on the operating cost. We have been trying to get the operating cost lower. We have been improving on operational efficiencies. We have ensured that at all levels be it in manufacturing or in sales or in general administrative expenses, we are able to improve our expenditure ratably and which is why you actually see the mix of all these three has resulted in our EBITDAs going up by about 3.7% in the current quarter as compared to Q1 last year.

Moderator: Thank you. We have next question from the line of Basudeb Banerjee from Antique Stock Broking. Please go ahead.

Basudeb Banerjee: If we see broadly for the whole industry, this small commercial vehicle segment that is the two-tonner and below segment is continuing to do very badly. In fact one can see that the MHCV industry is stagnating at present levels for past 6 months post contracting by more than 25% for 2 years, but the HCV segment is still contracting by more than 25%-30% even now. So when do we see the recovery in that segment because your Dost volumes continuously are closed to what 1,500-1,800 per month down from the highs of 3,000. So what is your comment on that segment sir?

Gopal Mahadevan: I will explain all the three parts. You actually addressed about the M&HCV, the second one is the LCV and third one is our Dost volumes. First, let me clarify that as far as our Dost volumes are concerned, we had deliberately taken kind of a cut back in production because what we wanted to do was flush out the dealers stock. One thing that we do at Ashok Leyland very clearly and consistently is to ensure that we do not push volumes into dealers. So when we found that there was a certain amount of accretion of stock at the dealers end, we deliberately decided that we will cut back on production and sales, and we possibly will see a step-up in terms of both volumes and revenues as we move forward in Q2 and Q3. And added to that is that we have just recently launched the Dost rigid axles which we believe is going to be a very key player in terms of reviving the volumes because this is an important introduction for us. And secondly is the PARTNER which is the 4-tonne vehicles where we have launched both the 6 Tyre and the 4 Tyre versions. The reason the 4 Tyre version is very important is because in cities for some reason, the 4 Tyre vehicles are allowed easy access into the cities whereas the 6 Tyre versions are not. So we have actually very recently launched the 4 Tyre version as well. So for us actually move forward, we are I would say positive that the volumes of the LCV business will grow. Now coming to the volumes of both M&HCV and LCV, one thing that we must remember especially on M&HCV is that while the reductions continue and we are not technically out of the woods so to speak, what we are seeing is that the rate of decrease in volumes is coming down. So that is important to note and we are also seeing that on the ground, I think our sales guys are feeling a lot more traction than what it was possibly even a quarter back. So the levels of enquiry, the finalizations that put the customers want to do seem to have gained a lot more activity than it was possibly even in January, February, March. So I believe that if things start looking positive for the economy, we would also see a recovery in the M&HCV market. As far as LCV is concerned, typically the LCV was also the last to degrow and we found the impact in the M&HCV market first and then the LCV business. So the recovery would also start happening sympathetically similarly. So once the M&HCV volumes start picking up, we believe that because of the general hub and spoke arrangement that is there in the entire Indian transportation industry, the structure of the Indian transport industry is such that there is a very clear hub and spoke arrangement that happens between long haul and medium haul and short haul. We would see the traction coming in the LCV segment as well.

Basudeb Banerjee: Sure sir and as you said that the difference between your wholesale and retail volumes because of the systemic inventory in LCV has shrunk. So can we expect Dost wholesale volumes to pick up from Q2?

Gopal Mahadevan: We believe so, yes.

Basudeb Banerjee: Can then if Dost volume starts picking up back towards that 2,500-3,000 per month, that will be a risk to your reported margin per se as per the way you account?

Gopal Mahadevan: No, let us wait and watch. I am not going to give a margin outlook because you see I would not call it a risk to the reported margin because the Dost volumes are not going to significantly swing my margins. It is not a key player in my entire margin. It is a very strategic introduction for us because if Dost kind of completes the entire product line, we are a very strong player in the above 15-tonne and now with the introduction of Boss, we are pushing forward also in the 9 to 12-tonne range. And for us with Dost and the PARTNER we are present in all tonnage segments. So for us, Dost volumes are important, but as far as the margins go, it is not just purely Dost, it is also a mix of exports, the kind of volumes that we have in the M&HCV, the mix that we have and the realization that we are going to get. Let us hope, I mean generally what we believe is that if the industry does start to revive and that will have to wait and watch as Q2 and Q3 pan out, then I think that the margin should also ratably improve.

Basudeb Banerjee: Sure and sir one last question. Sir, any comment on broadly futuristic tax rate because your MAT credit quantum is very much volatile. So this quarter it was much higher than normal compared to the PBT level. So any thought process how much tax rate we should take from a FY16 angle?

Gopal Mahadevan: Well, we will wait for quarter 2 before we can – I think that will give you a reasonable estimate. I think a MAT credit is, we have I would say some amount of MAT credit in the balance sheet which we expect to use as we move forward in the coming years. Definitely I am sure that the M&HCV segment will start improving and then we will start becoming reasonably profitable to use up the MAT credit.

Moderator: Thank you. Next question is from the line of Mr. Jay Kale from CIMB Securities. Please go ahead.

Pramod Amte: This is Pramod Amte from CIMB. I had couple of questions. One, good set of margins considering that you just improved your sales by 5%. Wanted to check the other expenses seem to have come down pretty drastically. Would you give some color what has led to the 20% decline in other expenses QoQ and how sustainable are these considering your cost cutting measures.

Gopal Mahadevan: Good question. I think there are multiple reasons for the other expenses coming down. One of them being that the expenses on R&D, on sales and marketing and on expense like inter-movement of vehicles into RSO, Regional Sales Officers movements have all come down. So to a certain extent, I would believe that we should be able to pursue this, but I would not be able to answer it specifically saying this quarter in Q2 will have the same rate of reduction is something that one cannot promise because each quarter has its own, I would say requirements in terms of expenditure. But overall what we have been able to do is to ratably bring down the expenses and that is the reason why we see that from the expenditure side, there has been a contribution to the profitability.

Pramod Amte: And second one again related to the expenses on the employee side. If I look at your annual report on the number of employees, there seems to be a substantial reduction last 1-1.5 years which got reflected in FY14 numbers, but if we look at FY15, again there is almost like a 10% rise which is happening. So how to look at the employee cost structure? Is it going to come down or was there a one-off in 15 or have you entirely got the benefit of this reduction in employees in your cost already and it is linked to the inflation.

Gopal Mahadevan: Okay, I will explain in two parts. You see, we had reduced the management staff by about 500 numbers last year and we had actually taken an exceptional charge if you remember in Q3 for about 47 crores. Now that was decided because we have to get our employee numbers down and you have also seen it in the annual report that there has been a reduction in the overall employee numbers. That had been a mix of both permanent employees and contracts. So we have actually seen the reductions happening. Now what we must also remember is the reason for the employee cost to go up in absolute terms in the current quarter has been because we had a wage settlement that happened in end of June/July of last year across facilities and the full impact of that starts coming in the current year. That is one. We had also, you must remember in last year the management staff had taken a 5% cut and obviously that 5% cut cannot continue permanently because given the fact of inflation, there has not been any rise in real terms that has happened to employees. So we had given a 5% raise in January of this year which we had mentioned in the call as well. So while the employee costs have gone up, we must remember that this is on the backdrop of quite a reduction in the management staff remuneration that happened because of the VRS. As we move forward, I think that we should expect a certain amount of increase for employee cost given the fact that we also have to retain talent and so the whole part of employee cost has to be put in two buckets. One is the reduction in absolute numbers that has happened, the positive effect of the VRS that will happen which will help to counter, I would say part of the increase that would result because of certain salary adjustments that have to be done to employees as well as the wage increases that have happened with workers. If we have not done the reduction in employee costs last year through a VRS, believe me the employee costs could have even been larger.

Pramod Amte: And two small questions on the balance sheet side. One, what is your working capital position now versus because the sales seems to be coming back in a much stronger manner than what you thought especially on the goods side. Are you realizing any norms there or how it is positioning, one. Second, what is the exact quantum of QIP usage split in terms of debt reduction or CAPEX if anything?

Gopal Mahadevan: Okay. Our working capital had come down to about 8 days in month of March and today we are at about 5 days higher, we are at about 12 to 13 days, but that is actually a planned increase. The reason being that as we anticipate higher volumes especially in buses and with the Sri Lankan Transport order, the JNNURM order, there is a certain necessity to pre-produce vehicles because we cannot do all of them in a month just before the export. So we are pre-producing buses. Some of the chassis related to these export orders for both JNNURM and for Sri Lanka as well as for tractors and tippers. A certain amount of pre-production is happening. Due to which, you are actually seeing the working capital going up, but we would stay within predominantly, we expect to stay within this range and not top up into the further significant amount of cash into working capital. The second part is with respect to your question on QIP where we had netted about 667 crores. All of this is going directly to reduce debt. We are not using it for CAPEX purposes. We had given an outlook I think at the beginning of the year when the investing community had asked us what is the expected CAPEX plus investment in the current year which we expect would be in the range of about Rs. 450-500 crores. So we still would maintain that amount and see whether we can reduce it from the announced levels, but we will have to wait and watch as year pans out.

Moderator: Thank you. Next question is from the line of Ashish Nigam from Axis Capital. Please go ahead.

Ashish Nigam: There was no impact on your depreciation cost post this new companies act. So could it show next quarter or have you all found some way around it?

Gopal Mahadevan: No, we have actually announced it very clearly in our results as well. What we have said is we have estimated the useful life of the assets. So we have decided to follow our useful life which has been predominantly what we have done in the past because we have done exercises for the useful life in the previous years as well and so we have not adopted the Schedule II.

Ashish Nigam: Okay, you all have the flexibility to do that.

Gopal Mahadevan: Yes, of course.

Ashish Nigam: Okay fine.

Gopal Mahadevan: Schedule II only kind of, it compresses the useful lives and it is also not appropriate if we were to the under report profits by taking additional charge on depreciation. Frankly if we chose to we could have because it did not have any impact on EBITDAs. But then we said that this is the predominant useful life and in the event any asset has to be impaired, we will take the impairment in the relevant quarters. That has been stated as part of the published results as well.

Ashish Nigam: Also you have listed Albonair and Avia as up for sale, so is that all the divestment you are looking to do right now?

Gopal Mahadevan: No, these are companies that are held for sale which we had also shared with many of you in our interactions in the past that Albonair has been looked at as a candidate for appropriate divestment in the current year. Aside of that, we will pursue to sell some of the noncore assets to augment cash further. Even as I am talking to, we are looking at one or two sales of assets being done, but I think one big chunk of it had been done last year itself.

Ashish Nigam: And lastly a housekeeping question. What is your working capital as an absolute amount right now. It was 580 as of end March.

Gopal Mahadevan: I do not know how you got 580.

Ashish Nigam: Is it 587 crores, your short-term debt had come down to?

Gopal Mahadevan: Yes. 587 is the short-term debt, but you are asking for operating working capital right?

Ashish Nigam: Yes. So short-term debt and operating working capital if you have that figure?

Gopal Mahadevan: There the operating working capital, we take receivables, payables and inventory and leave out the bill discounting that keeps going back and forth. My operating working capital from 244 crores has gone up to 457 crores, approximately about 200 crores.

Ashish Nigam: Okay and basically that 8 days going to 12-13 days.

Gopal Mahadevan: Yes, that is predominantly on account of pre-producing certain inventory…

Ashish Nigam: Sure.

Gopal Mahadevan: We are completely in control of that. That was the concern, to be honest with you of some of the investors. They are saying that the interest of actually reducing working capital, are you thinning out so much that you may not be able to pick up an upside when it happens. We are completely in control of that.

Moderator: Thank you. Next question is from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: My question pertains to the RM cost side where we have seen reduction on QoQ basis of about 200 basis points; I believe this is partly due to improvement in realizations. Have you seen any cost moderation on RM side as well.

Gopal Mahadevan: We are actually having both. We are having cost reduction. Last year, we possibly had a net cost reduction of about 1%-1.5% on the raw material side which has helped us to balance the increases that have been pursued by our suppliers on certain supplies, certain select category of raw materials and bought outs. This challenge continues even in the current year because we should expect cost increases to happen, but we are pursuing other cost reduction initiatives in the raw material consumption. Especially, we are looking at how to get the product cost down with both to change of engineering design and alternative materials. That is the project that is going on currently on that while I cannot share with you what are the numbers that we are targeting. Very clearly, we are pursuing as a company to get our raw material costs or our product costs down. But yes, there are demands from suppliers for increases in raw material and you know that our steel prices will be sympathetic to what happens in the industry. Having said this, overall reduction in the raw material cost is also being because of the mix change and the price increases that have happened which had been able to neutralize the effect of the raw material cost as well.

Jinesh Gandhi: Okay and on our other expenses side, you indicated that there has been benefit of cost savings. Would it be fair to say that full benefit is yet to get reflected in our numbers which will get reflected over coming quarters?

Gopal Mahadevan: See, we will pursue to have this cost reduction. I would not be able to say this is the full, I mean I would not want you folks to multiply this by four and say that this is the overall reduction that can happen because I know the importance of your question. But I would say that see this would depend quarter-on-quarter, but whatever reductions that we have done in this current quarter are not some one-off credits that have happened. These have been extremely planned and these have been monitored against what we have incurred in the past and which is the reason you have seen the reduction actually happening. In fact as we move forward, we may take up a couple of other areas as well. But let us wait and watch. What I can share with you is that overall we had shared with you the action that the company has taken in terms of reducing its overall operating cost be it in manufacturing or sales or other variable costs or in G&A. And that I would say those efforts are being pursued relentlessly quarter-on-quarter, month-on-month, day-on-day.

Jinesh Gandhi: And sir last question pertains to contribution of HCVs in this quarter vis-à-vis fourth quarter of last year and 1Q of last year?

Gopal Mahadevan: Let me give the bus and truck volumes together. Our M&HCV percentage this quarter was about 75%. the trucks and buses put together and in terms of revenue.

Balaji: See this quarter in terms of revenue, our M&HCV was about 75% and in same quarter last year, we had the number at about 79% and in Q4 the number was about 76%.

Moderator: Thank you. Next question is from the line of Amin Pirani from Deutsche Bank. Please go ahead.

Amin Pirani: Sir just on the CAPEX and investment guidance that you gave, the 450-500 crores that is for CAPEX as well as investment into other ventures or is there a breakup on that?

Gopal Mahadevan: No, it is CAPEX plus investments into ventures.

Amin Pirani: Sir on the CAPEX side, could you give us a sense of how much of it would be on R&D and product development and how much of it would be on say balancing your capacities if any?

Gopal Mahadevan: I just wanted to also use this opportunity to share the strategy of the company. If you look at it, we have almost completed our all major CAPEX investments over the last 5 to 6 years. So we do not foresee any further investments into capability building. We possibly are the only player in the market who is absolutely current on an engine. We have the Neptune engine which is being launched in the later part of last year. We have done a soft launch of the engine. It is an extremely high performance engine that we have comparable with the best in the world. The second one is we are absolutely current on the cabin as well both for the Boss and the Captain range of vehicles and our chassis as well absolutely current. So on this, we do not see any further CAPEX investments coming in over the medium term. What we would be doing for CAPEX would be as you rightly mentioned would be for maintenance CAPEX and if there is any debottlenecking that is required. And even that, let me assure that we are having an extremely tight leash on the spend because the basic idea is to see that we tighten the cash outflows on account of both CAPEX and investments and see how we can continuously keep improving our debt-to-equity ratio.

Amin Pirani: Fair enough sir and just as a clarification, the number that you mentioned for revenues from M&HCV which was 75% in this quarter, this excludes exports or this includes exports?

Gopal Mahadevan: This includes exports also.

Amin Pirani: So basically the remaining 25% would be spare parts and defense.

Gopal Mahadevan: Absolutely. It is 76% for this quarter and for same quarter last year, it was actually 79% and in the Q4 of last year, it was about 76%.

Moderator: Thank you. Next question is from the line of Imam Kapasi from Canara Robeco Asset Management. Please go ahead.

Imam Kapasi: Just to check whether the wage settlement was done in June this year or June last year?

Gopal Mahadevan: June-July last year. It was spread over 2-3 months across facilities. But the full impact started coming in – so if you look at Q1 to Q1, we would not have it in June of last year.

Imam Kapasi: No sir, I am just looking at the last quarter, fourth quarter to this quarter, production is down roughly around 20% volume. Still we have a 15%, so is it largely with the hike in salary means the January hike would also be there in the fourth quarter?

Gopal Mahadevan: See just to kind of clarify, one bunch of wage settlements happened in July and middle of August last year, and another bunch of wage settlement actually happened in December-January.

Imam Kapasi: And sir one more question. On the PARTNER four of the four-wheeler, the sales arrangement would be same as the current arrangement which we have for Dost, it would be completely done by Ashok Leyland?

Gopal Mahadevan: No, even now the Dost arrangement is done by Ashok Leyland only.

Imam Kapasi: No, but in Tamil Nadu, there is something different.

Gopal Mahadevan: In Tamil Nadu, there is different arrangement. The same arrangement will continue, but you see what we are trying to do is certainly we will start off with the same arrangement that we have for Dost, but we are also looking at how to optimize this entire arrangement and the network that Ashok Leyland currently has.

Imam Kapasi: And sir can you just put some light on what is the difference between a Dost and a PARTNER 4-wheeler if you can give some broad highlights?

Gopal Mahadevan: It is purely, see in terms of the application, in terms of payload. So if you look at it, the Dost is 1.25-1.5 tonnes vehicle whereas the PARTNER is a 4-tonne vehicle, 4-4.5 tonnes vehicle. So the size is different. So there are various, I would say payload vehicles that are available in this entire LCV range. What we are trying to do is see, the basic strategy of the company has been that it has been a medium and heavy commercial vehicle company where it has had the 15-49 tonnes range. After that, it kind of expanded the 9-12 tonnes range and while it had also expanded with the Boss range of vehicles. And simultaneously about 2-3 years back we said that we need to be in the LCV business and that is how we started Dost. Now what we are doing is using the platform of Dost, we have started to expand the range. So we had Dost and then now we have a Dost rigid axle, then rigid suspension and then after that we have launched PARTNER and then we have also launched absolutely state-of-the-art MiTR bus which is a 27 seater which is using the same platform as PARTNER. So what the company is doing is actually trying to expand its portfolio using the same platform.

Moderator: Thank you. Next question is from the line of Sonal Gupta from UBS. Please go ahead.

Sonal Gupta: Just one question. Just wanted to get a sense on the freight rates, have you seen any improvement in freight rates? What has been the trend there and also in terms of on the financial side, is there some financial availability constraint or single finance availability is pretty normal right now, just on those things?

Gopal Mahadevan: See what we have seen is that we saw the freight rates increasing even in the last quarter of the year. There was then some marginal correction which happened in April because freight rates took a marginal correction, but again what we have seen is that there has been a 2%-3% increase in freight rates in the current quarter also. Of course it varies geography to geography, but overall we have had a 2%-3% increase in freight rates which has been partly because of the pass on of the fuel increase as well. But generally there has been a demand pull that has led to the increase of the freight rates.

Sonal Gupta: Right and any sense you have in terms of freight operators capacity utilization, are you seeing a improving trend in that sense?

Gopal Mahadevan: We have seen that and what we are also seeing to be honest with you is that the fleet owners are actually now looking at adding multi-axle vehicles to the fleet. So the enquiries, etc., are coming in for the MAVs and like as mentioned, I think there is an expectation very clearly that the government is going to start off a lot of projects. I think the papers are full of them. Today's paper also mentioned that Prime Minister is actually looking at some of these projects which have been committed, very large infrastructure projects including port, roads, some part of river linkage starting, etc. They want to kick off these projects at least announced. While they have announced it in the budget, I believe that the Prime Minister is looking at kicking off these projects in the current month itself. Now if all of this were to happen, very clearly there will be a lot of, I would say demand for both tippers and tractors and the larger haulage vehicles and that is why we are also seeing the same effect where the fleet operators are looking at adding MAVs to their fleet and there is a lot of inquiries that we are seeing at the ground level. Definitely if we were to look at it, I do not want to sound overtly positive, but the mood is definitely very positive now on the ground. The mood is very clearly enquiring about deliveries, etc., and so as a company also we are ensuring that we are beefing up our supply chain to keep the whole thing ready even the volume starts to swing up.

Sonal Gupta: Right. Just on the finance availability side, is there any constraint or you think it is pretty normal for you?

Gopal Mahadevan: No, actually on the contrary from the peak of last year of 6,200 crores, actually we have been consistently bringing our debt levels down. This has been augmented through our steep reduction in operating working capital as well as sale of noncore assets and in the current month in July, we also completed QIP for about $110 million which actually strengthens our balance sheet position further. And as we move forward, we want to ensure that the focus on cash generation and operational efficiency and improving the gross margin through mix and once the volumes start picking up, you would actually find Ashok Leyland ready with complete suite of products which are ready to pick up the upside. Its network has expanded. We have almost doubled our network over the past 3.5–4 years. Our balance sheet has become more robust in comparison to what it was in August last year and our costs are also relatively down.

Sonal Gupta: Sir what I meant was for the customers because I think because of the NPLs, there have been some finance companies which have been pulling back. So in terms of for the customers, are you seeing this finance availability is normal or do you think there is a bit of a constraint or anything on that side?

Gopal Mahadevan: Yes, I think what we would see happening is that possibly in the last cycle we were having more the first time buyers and the first time users who were actually coming inside and then you could see a little bit of stress in the financial system. But as the recovery happens, then we would actually see the large fleet operators and the established players actually starting to crack up their demand. If that happens, there is no reason the finance companies will shy away from them because these are the staple guys in the commercial vehicle industry. So I do not see constraints in finance for established buyers, but if there would also be the section which could be first time buyers and first time users whom I am sure the finance companies will look at very carefully before lending money to them. But I think that if the demand starts to improve, you would also see that the entire quality of the asset portfolio for the finance companies will also start improving perceptibly.

Moderator: Thank you. The next question is from the line of Kapil Singh from Nomura Securities. Please go ahead.

Kapil Singh: Sir, I wanted to check how much was the utilization from the Pantnagar facility this quarter and how do you plan to utilize that benefit going forward, if you can throw some color on the targeted production from there over the next 1 or 2 years?

Gopal Mahadevan: See, I think that the Pantnagar is of strategic importance to us because what we have done is we have ensured that the lines that we have drawn are pretty automated and which has also kind of resulted in lower operating cost at the facility. Of course the tax benefits if and when they come would also be, I would say a big positive. But in terms of location also, it becomes a strategic importance because we consciously decided that we need to have a plant located in the North to service the Northern markets which are very important and also it creates huge positive in terms of supply chain efficiencies. See I cannot give an exact number, but I would say that we are possibly using the Pantnagar facility at around 45% this quarter. We would pursue to do that and there are certain products which are produced only in Pantnagar which we will continue to do. For example, the Boss vehicle and certain range of Captain vehicles are produced only in Pantnagar because of the absolute world class facility that we have there. So we would continue to pursue utilizing Pantnagar and at the same time what we would do is to ensure that we do the manufacturing optimization such that in the overall scheme of cost, Ashok Leyland becomes more operationally efficient.

Kapil Singh: Sir if I understood correctly, 45% of this quarter's volumes would have come from Pantnagar?

Gopal Mahadevan: No, I said the utilization of Pantnagar was at about 40%.

Kapil Singh: And going forward, would it be that you would want to utilize it as much as possible in terms of incremental volumes would come more from the Pantnagar facility than from other facilities?

Gopal Mahadevan: Yes, that is why. Let me put it this way. See I do not think I want optimized utilization of this facility or other facility. What we look at is when we do a production planning, we have certain vehicles coming out of certain factories because the lines are suitably drawn there in those facilities. What we would want to do of course is to utilize all facilities at the optimal extent, but I think there are certain products like Boss and Captain which come out of Pantnagar. Now there are certain other products which will come out both from Ennore and from Pantnagar and for example defense supplies are coming from Hosur. So it is not like I can start producing only in Pantnagar and ignore Ennore or Hosur. We would do a mix depending on the geographical demand and supply position and also the product that we want to manufacture and based on that we draw up a manufacturing plant. So this quarter, our utilization of the Pantnagar capacity has been at about I would say around 43%-45%.

Kapil Singh: And sir also wanted to check in the June volumes, would you have seen any pre-buying effects because at that point of time there was expectation that excise duty could be hiked. So was there anything of that sort or it was just a normal…

Gopal Mahadevan: There was some, but nothing significant. That does not shot up the volumes at all.

Kapil Singh: And sir also just wanted to check on emission norms side, we will probably see new emission norms coming up somewhere between FY18 to FY20. So would it require a next phase of CAPEX or something like that?

Gopal Mahadevan: Not at the moment because what happens is I think we have to have the rollout of BS4 happening in all the cities first of all. I think that rollout itself has not happened. So the government would be focusing on that. Our current engines are completely compliant for BS4 regulation and so is our latest series of engines of Neptune and what I would also want to add even if you were to go to the higher levels of emission norms which are 5 and 6, we have Albonair which is technology of selective catalytic reduction technology which is a Urea Dosing System, actually has capabilities and is currently supplying for Euro-6 Emission Norms. So we are as a company, I do not think we would make any huge investments in compliant with norms in the medium term at all.

Kapil Singh: And sir just last question from my side. I just wanted to check on the discounting front, where are we as a percentage of sales and where it used to be when the cycle was normal?

Gopal Mahadevan: See, instead of doing a percentage of sales that is what you see because….

Kapil Singh: I mean, as a percentage of ASP of the vehicle let us say.

Gopal Mahadevan: Let me put it this way the average discounts really would not help but what I can tell you is that if you look at the pure discounts, the discounts have possibly gone up between last June and this June. But what really matters is my net realization improving and my net realization has improved by about 150 basis points and that is what matters because discount is nothing but I think a practice that has typically been there in the Indian market but had got accentuated in the last year especially when there was a second year of demand coming down. But as we move forward, what the company has been closely monitoring has been whether the net realizations that the company had, is it improving or not? And yes, we actually see a perceptible improvement in the net realizations. So what we have done is there are certain parts where the discounts could be higher than Q1 last year, but then the realizations have got up much faster and we have had a 100-150 basis points improvement in the realizations on a net basis after factoring in the discounts. See the discount is not the thermometer for us to, I would say, assess the profitability. It is the net realization ultimately.

Moderator: Thank you. The next question is from the line of Chirag Shah from Edelweiss. Please go ahead.

Chirag Shah: Sir I have two questions. One is a follow up on discounts. Is it right to assume that discount as a percentage of your realization is coming down. If as an outside I want to gauge the overall impact. You used this fair average discount number. Would it be possible for you to share that number quarterly?

Gopal Mahadevan: See, the discount levels and if you want to know the number very broadly on an average basis, there are about 160,000 per vehicle. Now that is the reason why I want to be very clear when I give this discount number, I mean the reason why I want to be explaining it very clearly is because it is an absolute amount. It means nothing by itself. But you have seen the gross margin improved in the current year. If you look at it, gross margin improvement in the current year over material cost also or the contribution margin over material cost. The reason as I had mentioned in the earlier part of the call is two folds. One is because of the pricing improvement that has been done. The second one is because of the mix. So what we keep looking at is, how do I improve the mix of the products which will get me a better contribution or a gross margin as we call it internally. The second one is vehicle wise or vehicle group wise, market wise, am I improving the net realization in the product as well as region? That is the most important matter that we see because if we were to look at discounts, discounts are a factor of what practice is available in the market.

Chirag Shah: Fair point sir. Sir similarly I wanted to understand are the engine sales and the defense sales have gone up on YoY basis and sequentially. Can you throw some light?

Gopal Mahadevan: Yes sure. You see our engine sales sequentially if you were to look at it have actually come down because of what is called as the central pollution norms, CPCB and there has been a change in the overall pollution norms due to which actually the overall industry as well as the volume uptake had come down. We believe that from the second quarter we would actually see an increase in the engine sales. What was the second one that you wanted to know?

Chirag Shah: And defense and what I presume YoY both engines and defense would have grown in the quarter?

Gopal Mahadevan: No, actually the defense has grown over the quarter. We have done close to about 900 kit sets in the current quarter. There was not any significant sale that has happened in the same period last year and as we move forward, we believe that we should be having a stable performance on defense and it is expected that the engines volumes will start growing from Q2 onwards.

Chirag Shah: Okay, but for YoY also our engine revenue or volumes would have been down. Is it right way of looking at it because engine I presume would be a more profitable business?

Gopal Mahadevan: Yes, engines the volumes have been down in the current quarter this year.

Chirag Shah: Versus last year same time.

Gopal Mahadevan: Yes, last year same time.

Chirag Shah: Yes, the second question you highlighted that tipper and tractor demand has seen a positive trajectory. Can you share some thoughts over that? Is it more of a replacement demand that is coming in? What is the kind of buying profile of this, is it replacement demand or is it new addition that is happening with the existing customers?

Gopal Mahadevan: I think to be honest with you it is a mix of both, that is what is happening because we must remember that over the 24-month period when this industry has witnessed tremendous amount of degrowth, the replacement cycle had also got stretched. Typically vehicles which would get replaced at about 4 years-4.5 years were getting stretched to 5 and 6 years. So people, especially the large fleet and the medium fleet owners are looking at being ready to capture the upside when it comes and the second part is that there is also a requirement for new vehicles because we see that generally the mood at the ground level seems to be definitely optimistic, but we would have to see that these things get converted to higher volumes. That is why I would say that while we are cautiously optimistic about the volume growth in the later part of the current year whether it would happen in Q2 or Q3 is something that we have to wait and watch. But as a company what we are doing is we want to be clear that we need to have a supply chain processes and pipeline very clearly ready to serve the upside if and when it happens.

Chirag Shah: Fair point and just a clarification, you highlighted on the raw material side. Are there indications of cost pressures as well as conversion cost pressures are likely to inch up in terms of your negotiations? Can you share some light over there? How are you positioning of that?

Gopal Mahadevan: See, we would always be negotiating with our suppliers on a proactive basis to see that we are able to get a benefit not only for the supplier but also for Ashok Leyland. So our discussion with suppliers always looks at cost benefit and how we can optimize the input cost for the company. So those things continue. But there are certain things like commodities in which there is a price increase. If there is a price increase, there is a price increase. So one of the key input raw materials which is like a commodity is steel. So if steel prices go up, then it will not only for Ashok Leyland but it will be for all companies who use steel as a critical raw material. What we try to do is to optimize our supply chain cost through kind of improving processes at vendors' places, helping them with the design, helping them with the processes especially for aggregates and for where they help us in outsourcing some of the manufacturing.

Chirag Shah: Fair point.

Gopal Mahadevan: So it is a mix of insourcing, outsourcing, getting in new supply if necessary, getting in new materials and also negotiating with vendors for better rates. So it is a mix of all of this.

Moderator: Thank you. Next question is from the line of Aditya Makharia from JP Morgan. Please go ahead.

Aditya Makharia: Just two questions from my side. This year for industry growth would you like to put in any estimate on growth rate for the year?

Gopal Mahadevan: I would not want to put in a growth rate for the year. I would only say this thing this year that we are cautiously optimistic that the growth should start happening in the second half of the year given by the macroeconomic conditions and what the government has been promising. See I call it the triple poise because if we believe that the economy is going to grow and there are indications that the economy would move to about 5.6%-5.7%. If that is going to happen, then logic determines that the commercial vehicle industry would also need to grow because the commercial vehicle industry not only looks at new infrastructure projects or new projects being awarded, if the general levels of production are stepped up which is what GDP growth is about, then there is more goods to be transported and if that is going to happen along with the initiatives that the government has announced in terms of some of the kind of speeding up the work on infrastructure projects, definitely we should see the commercial vehicle industry growing. If that is going to happen, there is no reason why Ashok Leyland which is a No. 2 commercial vehicle manufacturer in the country should also not see growth because it is completely ready on its engine, its cabin, and chassis. Its CAPEX cycle is completed. It has got manufacturing capacity in place and it is actually driving its operational efficiency. So there is no reason why this company should also not grow and we must also remember that from the buses side, we expect that further growth happening in terms of both exports. We have the recent order from Sri Lanka. We are looking at certain orders from Africa and Middle East. If which they happen will also contribute to the topline growth and also the JNNURM orders that will come in.

Chirag Shah: Sure, okay sir. Just in terms of competition which competitors are really stepping up given that we have Eicher holding of the new Pro Series and Daimlers been one-off, I guess past two years?

Gopal Mahadevan: Yes. So you want me to comment on competition?

Chirag Shah: Yes, just your thoughts, very broad level.

Gopal Mahadevan: Well, I cannot at the moment. I do not think I can either comment on their products or strategies per se. All I can say is that we do respect competition. We keep ourselves aware of what they are doing. But Ashok Leyland has its own strategy. So Ashok Leyland pursues its own strategy despite what competition is doing. It has its own product strategy. It has its own marketing strategy. It has its own market strategy. It has its own cost strategy. So while we do use competition sometimes as a benchmark, I think we keep our windshield driving strategy rather than driving through review view. So I think we are as a company well-positioned to capture the upside in the commercial vehicle market and we are I say a better positioned than most players in the industry today.

Chirag Shah: Sure. Just last one on housekeeping question sir. Rs. 160000 was the discount this quarter. What is it last quarter?

Gopal Mahadevan: It was possibly about a tad higher. You know the discount levels were at about almost the same level as last quarter.

Moderator: Thank you. Ladies and gentlemen due to time constraints that was the last question. I would now like to hand over the floor to Mr. Mihir Jhaveri for his closing remarks. Over to you sir.

Mihir Jhaveri: Yes. On behalf of Religare Capital Markets, I thank the management and all the participants for the call. Thank you.

Gopal Mahadevan: Thank you Mihir.

Moderator: Thank you all. On behalf of Religare Capital Markets that concludes this conference. Thank you for joining us today and you may now disconnect your lines.