



“Ashok Leyland Limited Q2 FY '18 Post Results Conference Call”

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**MODERATORS: MR. ANNAMALAI JAYARAJ – BATLIVALA & KARANI
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Moderator: Ladies and gentlemen, good day and welcome to the Ashok Leyland Ltd. Q2 FY '18 Post Results Conference Call hosted by Batlivala & Karani Securities India Pvt. Ltd. As a reminder, 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 * and then 0 on your touchtone telephone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Annamalai Jayaraj from B&K Securities. Thank you, and over to you, sir.

Annamalai Jayaraj: Thank you, Inba. Good morning, everyone. On behalf of B&K Securities, welcome to 2Q FY '18 Post Result Conference Call of Ashok Leyland Ltd. I also take this opportunity to welcome the management team of Ashok Leyland Ltd. We have with us today Mr. Gopal Mahadevan, President (Finance) & CFO; and Mr. K.M. Balaji, Vice President, Corporate Finance.

I will now invite Mr. Gopal Mahadevan for his opening remarks to be followed by a question-and-answer session. Over to you, sir.

Gopal Mahadevan: Thank you very much and good morning to all of you. Let me just very quickly run through the numbers. I am sure all of you would have gone through the published results and I know what the questions are going to be, and let me try to address those questions also at the beginning and then specifically address some of the issues that we have. Unfortunately, ladies and gentlemen, I have a hard stop at about 10:50 because I must get into a town hall meeting with MD, so you will have to excuse me because we are going to be 5 minutes shorter than the planned time. So, I'm going to do this briefing very quickly.

The overall volume for Q2, if you look at it, the total industry volume was 80,192 and versus 66,592 in the same period last year. And this is SIAM data, so the industry had actually grown by about 20%. Ashok Leyland in the same period has grown by 22% at 26,964 units. And our market share at the end of Q2 was 33.6% as opposed to 33.2%, again, based on SIAM data, let me remind you, which is a 0.4% higher. But frankly, I mean, it is not about showing that we are 0.4% higher or we are marginally lower, but I'll discuss more about the larger things that are happening in the industry and some of the good things and some of the challenges that we are facing as well. Overall, exports have grown at 39%. It is satisfying to know that there's a demand, but I will also tell you where this mix has changed and had some marginal impact in the current quarter's profitability.

Overall, revenues stood at Rs. 6,047 crores which is a record high. I must complement the team here in Ashok Leyland for the revenues that they have posted despite the challenge that we've had in the industry, and that has shown a 31% growth. EBITDA margins, of course, have been at 10.1%, as compared to 11.6% last year, and the general feeling has been that why is it that the EBITDA margins have come off despite the revenues growing at 31%. Now let me address that. Before that, let me step back. I mean, at the end of Q1 this year, we had seen the total industry volume actually reducing by nearly about 32% and at that point in time, when we had spoken, I

had shared with you that we expect a little bit of recovery in Q2; and possibly Q3 would also be a good quarter. Q4, we will have to wait and watch because we must recollect that in Q4 FY '17, there was quite a bit of heavy demand because of pre-buy. So, if that base effect is going to be a challenge this year for Q4 we will have to wait and watch. But the industry has also gone through 3 quarters of uncertainty. You know December '16 was demonetization; the whole economy almost came to a standstill. March '17 was again a BS-III to BS-IV sudden ruling that happened, and then there is quite a bit of demand uncertainty in April, which was followed through in May. June, saw some recovery, but the total industry volume had come off. And then on 1st of July, GST was implemented. Again, GST directly influences not only trade but also the movement of goods, and that's exactly what happened in the month of July also. But we did see recovery in August and September. Now when this pullback has happened, as you know, in terms of a growth, it looks like some of the uncertainty is going away. The government is also trying to provide clarity on how GST is going to be going forward. So hopefully, in the second half, one of the things that we are expecting, but I'm not going to give any forward-looking statement because people do, when they talk one-on-one to me, saying, "How do you sound so positive?" I'm not positive. I'm just trying to be sharing our perspective at this moment is that if things do go well and if there are no other unprecedented happenings that happen in the economy and if the government pursues its investment-led strategy and starts to activate a lot of projects, we possibly will see the industry actually growing about 5% to 10% at the end of the year. This is our projection at the moment. Why am I saying this? From the perspective of the company, we'll have to ready our capacity, do our production planning, and we must plan for growth. I cannot plan saying these things are going to be steady static. This is one part. But the second part of it, and there's another positive outcome that's happening is that I think GST is seeing faster movement of goods, and that actually is releasing existing capacity which is going for faster turnaround times. And as I had mentioned, fleet operators want to invest more into a business which is becoming more efficient, and it's not actually the other way, where people fear that this is going to release 10%, 15% capacity, so owing to which, demand for trucks will come off.

The third most important thing, which I should have stated first, is that iEGR had settled down very well. A lot of concerns in April saying that you guys are the one who are going for EGR, whereas the rest of the industry is going for SCR. Is it going to work? Well, we were pretty confident about it. We said let the demand speak for itself instead of we stating how good the technology is. The fourth thing is, of course, in certain parts of the country, including Rajasthan and in Uttar Pradesh, we are seeing greater growth coming in. We are expecting that to pan out in the rest of the country, and that's extremely good for the industry because the players get a more profitable turnaround of the business. The vehicles are not misused anymore. The freight rates, equivalent adjusted freight rates are better. The vehicle profitability, fleet operators' profitability is better, and overall safety in the industry also improves. But one thing that kind of gives a crease in my brow and deep frowns that the heavy discounting that's happening. I don't understand why there should be such level of discounting. I think while everybody should pursue customer acquisition, it should not be done in a way that it doesn't make economic sense. So that is why I know in October, we had seen that the volume share had come off. People were extremely worried. Let me tell you that this was not because we were a witness or we were not

a victim of circumstances, but we said that we will move away from certain businesses. We are very clear. We are not going to sell trucks and buses at losses. We are not going to give a customer a truck and also leave some money on the table. So we decided that we will not do it. We are very clear that there are multiple avenues to actually use our capacities and we are not going to get too concerned about a quarter-on-quarter performance because, frankly, if we get into that kind of a pressure, we will do long term; short term if everything will look good. But in the medium term, we will actually be doing a significant damage to ourselves. So, we really do not understand why pricing has to go the way it is, because the industry is not at the level that it was in 2013-2014, when 50% of the industry had gone down. We had smartly recovered. We are at 320,000. And if you really look at the tonnages, the tonnages are far higher. So there is no reason for you to want to offer greater discounts when actually raw material prices are coming off.

Now I'm going to take one more minute to explain the performance so that then we can go straight to the questions that you have. This quarter, our 10.1% EBITDA as opposed to 11.6% EBITDA at the same quarter last year has got 4 or 5 reasons for it. And this is not a justification, it's only a reason. We would certainly like to be more profitable. It's not that we don't want to be profitable, but there are reasons for it. The first one was, in the same quarter last year, if you remember, there was this very good export order that came from Senegal and that had a good margin, and that resulted in nearly about 200 basis points in improvement in margins in Q2 of last year. The second one was, as you're aware, we had nearly 55 crores price escalation clause, reimbursement that happened from the supplies made to defence. That was a one-off event, and that actually helped to shore the profitability as well. But well, it is part of the business and we got it. But we didn't want to, what you must remember is, we didn't account for it till such time we got the money. Anybody else could possibly have said, no, let us account for it because it's part of the contract. But we were conservative. We recognized the income only when we received the money. The third thing which has impacted profitability, which I shared about and I'm sure all of you will have questions on, is the heavy discounting that's happening. And that has put pressure on margins. No doubt about it. We have not done a price increase in Q2 of this year. In fact, in Q1 also we were not able to do it, but you must remember my dear friends that we were the only player in the country to have increased prices in April when we moved from BS-III to BS-IV. BS-IV vehicles are more expensive than BS-III and we cannot sell it at the same price as BS-III, but competition did not do it. So you must remember that our sales and marketing guys were actually facing a challenge in terms of being increasing prices but also gaining share and gaining customers over the last 6 months.

The last one is raw material price increases. All of you know about this very well. Steel prices continue to increase quarter-on-quarter, month-on-month, and that has actually also put pressure. And when you're not able to pass on the pricing, it does put pressure on the margins. The last one was on exports. I said that I will delve a little bit on exports. We had shared with you on 31st of March. I think we had a separate call. We possibly were the only player to have a separate call on the BS-III to BS-IV and we had told that we have about 9,500 vehicles, and we are confident that we will be able to manage this without any significant losses. That's exactly what has happened. We provided for about 15 crores in the March accounts. But what we have is that

we have exported nearly about 2,000 of these vehicles and converted the balance. We still have about 1,000-1,500 inventory, and those exports could not be done at a very high margin. But we have come out reasonably unscathed out of this BS-III to BS-IV and that is also another reason why you've seen a slight depression in margins. Having explained the performance now, I'm going to give the call back to the moderator for the questions to start.

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

Binay Singh: My first question is on the top line, if you could share with us a breakdown of your top line and also talk a little bit about how truck ASPs have done sequentially because the product mix was very strong this quarter.

Gopal Mahadevan: Truck ASPs is what you said? I didn't hear what you said.

Binay Singh: Sir, like for example, the average selling price of a truck, like the ASPs this quarter have gone down. So I believe that could have gone down on account of the product mix moving towards more weaker revenues and less players and less defense and all, so if you could give us a breakup of that.

Gopal Mahadevan: Okay, I will try to give some amount of mix details, but broadly we don't get into that kind of a segmentation because we report as a one consolidated entity. But overall, actually, the truck business accounted for about 65% of our revenues and the balance was the non-truck business. Exports accounted roughly for about 10% of revenues. But you'll see, what has happened is the good performance in exports has been at lower margins because we have not had significant Africa exports. They have been predominantly into U.A.E., which is reasonably profitable. But Sri Lanka and Bangladesh are not really the best, most profitable exports that we have. As far as buses are concerned, the margins are a little bit under pressure because the private orders have not come out the way it is expected. The overall industry has also seen a reduction in volumes because the STU tenders did not take off. And the net price realization has been flattish, but we have actually seen discounting levels go up in the current quarter. And with the material price increase in steel, actually, the margins have come off a little bit.

Binay Singh: Okay. And sir, how was Defense and spares for you?

Gopal Mahadevan: Well, Defense has been reasonably good. I would say that if you were to look at between Q2 and Q1, our Defense revenues sequentially I'm talking about. If you were to look at Defense revenues in Q1, it was about 270 crores. We are about 200 crores in Q2 of the current year. And in the same period last year, it is almost the same level of Defense revenues. It's not been exceedingly high as compared to, but then also you must remember that we had this 50 crores coming in from VFJ which actually went straight to the bottom-line in the same quarter last year.

Binay Singh: Right. And sir spares would be somewhere in the range of 300 crores or so for you?

- Gopal Mahadevan:** Yes, they are about 300 crores. I think we are doing reasonably well. But you must remember, spares is the most affected in the GST because, you see a lot of spares retailers would have had inventory which they would not get benefit on because of inventory more than 1 year, the benefit was going away. And the retailers, they are not Ashok Leyland standalone retailers but the spares retailers who would have inventory which is quite dated. So the level of supply that happened in the month of July and August was not very high, but we saw recovery in the month of September. And I believe that spares will grow pretty well, so at steady state even under these trying circumstances, let me tell you, Ashok Leyland has never had 100 crores consistently every month and that is happening now.
- Moderator:** Thank you. Our next question is from the line of Pramod Kumar from Goldman Sachs. Please go ahead.
- Pramod Kumar:** Gopal, I joined the call a bit late. So I just want to clarify, have you quantified the Pantnagar impact, where the benefits which have got truncated?
- Gopal Mahadevan:** I have not quantified it. Thank you for asking, but I missed it. That is another reason for us to actually see this pressure on the, I would say, the slight reduction in margin, and I'm not going to use pressure because we are not under pressure of any sorts. The point is we typically get about 13% excise duty benefit before GST and today that number has gone down to about 8.2%. So there is a 5% impact that can happen, but the state government is still to come back whether they are going to give SGST part of it. I believe that the Jammu and Kashmir government has assured investors that they are going to do it and we are hopeful that, we are only hopeful, I'm not indicating that it has happened, but I presume that the Uttaranchal government will also see reason that they need to pass it because the whole investment has been done based on tax incentives.
- Pramod Kumar:** Right. And how much of this is spending in terms of what is the expiry date for you for these benefits? I guess it's end of FY '19, right?.
- Gopal Mahadevan:** 31st March 2020.
- Pramod Kumar:** So even if the state government doesn't do, you will continue to get this benefit from the central government, which is 58%, right?
- Gopal Mahadevan:** Well, let me put it this way. It's not that we are not. Obviously, the Pantnagar plant continues to be more competitive than the other plants because we have the tax incentives.
- Pramod Kumar:** Okay. Thanks for the clarification. But the impact for this quarter would be roughly 30 crores. Is that understanding right, thereabout?
- Gopal Mahadevan:** Yes.
- Pramod Kumar:** Yes. And the second question is on the market share performance, Gopal, as in there has been some bit of a reversal in the market share gains, what we've been clocking consistently for the

last 2 years plus. So given that, where would you put Ashok Leyland's growth in context of the industry growth? I guess you're guiding for a growth for the industry anywhere between 5% to 10%, depending on how the second half goes. But where would you put Ashok Leyland's growth in context of industry growth?

Gopal Mahadevan: Well, if the industry is going to pursue the heavy discounting and passing on, that is why I've said, supply a truck and also give some money to the customer, we will possibly not want to participate in that kind of a growth. But I presume that at some point in time, sanity will return. And then if that happens, we are expecting that we'll grow at the same rate as the industry. You see, the reason is that, that's why I said, since you joined late, I'll repeat. We are not a victim of circumstances. We decided to stay away from some of the businesses which don't make financial sense.

Pramod Kumar: No, because the reason why I'm asking this is the earlier the expectation was you'll have a healthy double digit growth. So is there a reason to relook at that target because first half is generally lower, okay; second half has a favorable base. But I'm just asking, is there a rethink on the double digit volume growth aspiration for FY '18?

Gopal Mahadevan: Yes, we are not able to give because, frankly Pramod, it's very difficult to actually say how the market is going to pan out as we move forward. Is the discounting going to be higher? Is the discounting going to be lower? I am just not too sure. But if there is sanity in pricing and if we find that everybody is not going to chase customers by reducing prices because they have nothing else to offer. Well, then we are not going to participate in such deals. But if there is a competitiveness that comes in because of total cost of ownership or new products or new technologies or service network, I'm sure that we will pursue those kind of strategies. But the idea is not to walk away from market or walk away from market share, but we don't want this to have this month-on-month, quarter-on-quarter performance pick up pressure because then what we will do is we will only hurt ourselves in the medium term. We don't want to be doing things which would like the industry witnessed in 2012-2013. So to answer your question in a very simple and straightforward manner, we would want to grow at the same rate as the industry, if not higher, and that is our plan. But if we find that there are deals in which the pricing is not making sensible gross margin and there are no margin, we will walk away from the deals. We are very clear about that.

Pramod Kumar: Okay. And finally, on the GST, is it sorted out in terms of the impact on fleet owners or do you still see some teething problems? I'm just trying to understand what's your outlook on the industry? Has it changed in a positive way or are you seeing more bit of concerns with the GST implementation?

Gopal Mahadevan: Well, I think the greater clarity is coming on GST. People are settling down to the new regime. It will take some time because not only is it a very, it's quite a tectonic shift in terms of tax implementation, but it's also pretty complex in terms of the logistics. So there is still returns to be filed, etc., how credits are going to come, the industry is getting affected. Everybody has got input credits which have not been utilized, and that has affected the cash flows. Hopefully, we'll

see that this will ease out in the coming months. The government is also aware of it. That's why they have been enhancing the return dates, etc. If that happens, I would say that the industry is actually going to see some benefit. I think certainly movement of trucks and buses have eased over the borders. And if that has happened, then that is going to actually see more investments coming into the sector.

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

Sonal Gupta: Sir, just to clarify on the Pantnagar thing. So have you accrued for the state government part as well in our numbers or we are not accounting for that as yet?

Gopal Mahadevan: We are not accounting for it. We would never do that.

Sonal Gupta: Okay. And could you also give us a sense on the discounting, I mean, like the average discounting last quarter was at around 350,000. So where has this moved to in Q2?

Gopal Mahadevan: Well, we have had average discounts in trucks going to about 350,000. I don't want to comment beyond this, but I think the market, there are participants who have offered 1 lakh more than what we have offered to acquire customers.

Sonal Gupta: But sir, for you, would the average discounting level be same as last quarter?

Gopal Mahadevan: Yes, the good average discounting levels have almost been the same as last quarter. Our net price realization has been maintained in the current quarter.

Sonal Gupta: Okay. And sir, just lastly, to understand, again, there has been a movement because of the shift to GST. So could you just explain the other expenses have gone up quarter-on-quarter by a substantial amount? Is this just because of the increased production or has there been some changes and some reclassification, just to get a sense?

K.M. Balaji: Yes. Actually, the other expenses contained some 60 crores of the HFL, the Hinduja Foundries related expenses which are not there in the previous year's quarter. Otherwise, if you knock off that 60 crores, the other expenses will be at the same level of last year.

Gopal Mahadevan: Okay, so I just wanted to add here, I start with the Hinduja Foundries. I think the team has done a wonderful job. And I'm not trying to sound optimistic here. In Q2, the EBITDA for Hinduja Foundries was a positive 8%. So please look at it that this quarter has got the foundries expenditure also. And on an YTD basis, we have got salaries. The wage bill of Hinduja Foundries has also got added, and so have the other expenses. So if you were to look at it on a consolidated basis, while Hinduja Foundries' EBITDA is at about 8.5%, Ashok Leyland could have been slightly higher, so merge we have got a 0.2% impact on account of the Hinduja Foundries. But the most important thing is, when we acquired the company, we had mentioned that in the medium term, which is 3 years, we will try and make Hinduja Foundries' EBITDA accretive to Ashok Leyland. So we seemed to be on track. The team has done a wonderful job

in terms of product rationalization, manufacturing expenses reduction in terms of rejects improving the throughput. So all of this has actually seen the EBITDA margins going up in Hinduja Foundries.

Sonal Gupta: Okay. And sir, just lastly, you said 50 crores-55 crores of price escalation, what entity was that? I didn't get it, sorry.

Gopal Mahadevan: This is the Defense, the VFJ business.

Sonal Gupta: Okay. So this was accounted for in Q2 last year, is it?

Gopal Mahadevan: Accounted in Q2 for last year, I thought we had mentioned that, because what happened is, you see, there is nothing untoward about this. You see typically, these are long-term contracts. And we have been a little conservative there, that is we didn't account for the entire price escalation that comes in based on certain indices. We waited for the money to come in before we accounted for it.

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

Kapil Singh: I wanted to know, has there been a price hike in Q3?

Gopal Mahadevan: I don't believe so. There has not been any significant price hike in Q3. You're talking Q3 or Q2?

Kapil Singh: Q3. So far, I mean, October-November?

Gopal Mahadevan: After 1st October, we have had a 1% increase in certain models in the truck business.

Kapil Singh: Okay. And the discounting trends still continue around the same level as they were in Q2?

Gopal Mahadevan: Well, yes, they are.

Kapil Singh: Okay. And should we expect some incremental pressure on the material cost?

Gopal Mahadevan: I believe so because I think that the steel price duty continues, the steel prices are continuing to increase. You know the profits that the steel companies are making. So somebody has to pay for that. But the challenge has been that so far, we have not been able to really make some price increases to neutralize the effect of the steel price increase. So better still, we have kind of put our head out and done our price increase in November. Let us see whether we'll do one more in January, February, March.

Kapil Singh: Okay. And how are we accounting for the incentive from Pantnagar. Is it a part of material cost?

Gopal Mahadevan: Yes.

Kapil Singh: Okay. So it is getting netted off from the material cost. Understood.

Gopal Mahadevan: So, I wanted to tell you that part of it comes in material cost, but there's also price that there is an adjustment in the price realization, right, because in Pantnagar, what happens is that until last year, the adjustment was happening in pricing fully because your NSR or the net sales realization was going up. Now the adjustment is happening partly in the material cost. But what I want to tell you is net-net, whether it is NSR or material cost, we are only accounting for what the government has notified, which is the excise tax that they will give 58% or 14% CGST. So that 8.1% or 8.2% is all we are accounting for.

Kapil Singh: So from going ahead, we will be getting a fixed revenue number as refund from the government, right?

Gopal Mahadevan: It will be a percentage of the CGST. It is not a fixed revenue.

Kapil Singh: I understand that. So you will split it up between material cost and revenue when you account for it going ahead?

Gopal Mahadevan: We may account for it. See, we are just discussing it with the auditors. But frankly, it will not affect my margins. It's not going to significantly affect my topline. I mean, there will be no change in the margin accounting. Let me put it that way. And it's not typically accounted in my topline either.

Kapil Singh: About the LCV business, we have been doing well and we have plans of launching, I believe, one product every quarter. So if you can share some more update on that?

Gopal Mahadevan: Yes. I think the LCV business has been doing well. I think I must share with you, but this is not some accounting aspect that I can tell you about. When we look at the overall LCV business, which is the 3 subsidiaries put together and the LCV operations of Ashok Leyland, which is the marketing and the manufacturing operations, possibly for the first time, we have actually become PBT positive. And even that business is at about 8% EBITDA. So very clearly, the turnaround has happened. We are extremely happy with the 100% acquisition of the LCV business. We are excited by it. We will make some investments. And then, of course, because those have been there in the system for 6 years or so, but we will be expanding the product range. We will be increasing the total payload of the vehicle also because there is growth today. There is a partner which is a 6T vehicle but then there is also growth. So somewhere in between, we need a vehicle. So we will ensure that we are filling in slots. And there will be a product introduction that would happen, some 6 or 7 product introductions would happen over the next 12 months.

Kapil Singh: Sir, what is the tax saving that we should expect on account of merger of the LCV business?

Gopal Mahadevan: We have not merged the LCV business.

Kapil Singh: No, I mean, going ahead, what is the outstanding loss that we have?

Gopal Mahadevan: Well, see, I don't think it is as simple as that. If we are going to merge it and if there is an opportunity, we'll share with you, because please don't make the calculation because it is far more complex than what we have been getting.

Moderator: We'll take the next question from the line of Jamshed Dadabhoy from Citigroup. Please go ahead.

Jamshed Dadabhoy: Sir, in your opening comments, you said that you're planning for growth and you're hoping that the industry grows between 5% to 10%. Given your capacity utilization is already quite high, what should we see in terms of capacity expansion and CAPEX over the next 2-3 years? And related to that question is that you've seen a lot of growth in the 37 tonnage plus segment this year. Do you expect that to continue? And how will that change your CAPEX plans going forward?

Gopal Mahadevan: Well, I don't think there is any specific CAPEX specifically for 37-tonner. I'll answer this question little more holistically. That is one is yes, we will need to invest into balancing CAPEX because we are debottlenecking the plants continuously. But at the moment, I don't think we are going to make one big bunch of 1,000 crores into 1 year or something like that. I think our CAPEX will continue to be about 500-600 crores every year. And that's what we'll pursue because it takes time to roll out the CAPEX, point number one. Point number two, obviously, we will have to beef up the CAPEX in the fully built facilities because as per regulation, we are seeing uniform bus body code getting rolled out. So we will need to have bus body building capabilities. The second one is fully built vehicle solution facilities. So all of this is going to add to CAPEX. But it will also add to revenues because see, this is not CAPEX just to say that let me build it and let us build it and they will come. It's like that I am going to have a fully built capacity and the government regulation is that you have to build a fully built vehicle. The third thing, of course, is electric vehicles where we are making forays both in single-charge long-distance technology whether it will be larger banks of batteries and as well as swappable battery technology where we have tied up with Sun. So there will be CAPEX there also. But again, we will have some amount of clarity as to the CAPEX that we'll have next year and the year after that somewhere in the fourth quarter because our guys are putting together a larger plan. We are also trying to see how much more integration can we have in our operations to actually reduce our operating cost.

Jamshed Dadabhoy: Okay. Sir, what is the fungibility today in your plants between say 16- and 25-tonner versus 37 and 49-tonners?

Gopal Mahadevan: They're coming from the same assembly line.

Jamshed Dadabhoy: So it's a fully swappable capacity. You wouldn't have any incremental capex.

Gopal Mahadevan: Yes. But what we don't do let me tell you, see, it is not like I will do a one 37-tonner and then after that one 15-tonner and then another 28-tonner or something like that. We obviously do it in batches because there's an economy that happens, right. That is one part. The second part of it is that we have carved out that the box and capital manufacturing happens predominantly in

Pantnagar because it's highly automated. But we have now moved both manufacturing to Ennore also. But we are trying to kind of get the economies of scale of manufacturing of heavy production runs in specific thing because what happens is the efficiency of the line becomes better. But of course, if you were to look at defense, for example, of a lot of defense manufacturing happens in Hosur. So you kind of carved out lines in certain sectors. But other than that, in terms of a 37-tonner or a 49-tonner, it is not that it will only be in one line, say, in Ennore or one line in Pantnagar. It's not like that.

Moderator: Thank you. Our next question is from the line of Aryn Pirani from Deutsche Bank. Please go ahead.

Aryn Pirani: Sir, just going back to the capacity and the investment position. Today, as we stand today, can you help us understand, what will be your overall assembly capacity?

Gopal Mahadevan: Well, I don't know why you're asking for assembly capacity. Is there any particular reason why you're asking it?

Aryn Pirani: Since we are talking about growth and if you think about, say, 5% to 10% this year and looking at the cycle, we still could grow by 10% to 12% over the next 2 to 3 years. So I just have to figure out, at what stage will you have to think about the new facility, if any? Or how much debottlenecking can you do over the next 2 or 3 years? Just trying to understand that with more clarity.

Gopal Mahadevan: Because if I said that my capacity is 150,000 units and we are at about hundred, then you will have to conclude around it because the capacity is factoring in, one, the location. The second one is various segments of it. For example, there is Neptune, there is engine capacity. Then there is machining capacity and then engine assembly. Then after that, vehicle assembly, right. And then gearbox facility. So there are multiple capacities that we have to look at. And then within that, I don't want to complicate it or make it sound complicated. Some of it, we are outsourcing. Some of it, we are actually doing in-house. So overall, I can say that we will start...and then there is paint shop also. That's another part, that we will have to invest in a paint shop. So what I can tell you is that we will be investing in capacity as we move forward in Hosur, possibly in Ennore also. We have, of course, the Pillaipakkam land by the way, which is part of the LCV acquisition. But we are not going to invest into a specific greenfield unless we see some economic sense in that. So if we see that it make sense for us to debottleneck the capacity in the existing facilities, then we are going to do that. So even as I'm speaking to you, while I can't give you specific details because it is not yet confirmed, but we are looking at debottlenecking some of the LCV capacity. So you see, what happens, I'll tell you, you see, for example, we have just added an engine assembly facility for the engines in Hosur. We can create another facility, even though it was out of some other facility outside Ashok Leyland. But then, of course, we move the existing line to another facility. We have moved our defense, for example, into Ennore because there is spare land available and we thought it will be much closer. Then what happened to overall inspection, quality systems, manufacturing strategy, everything can be looked at by the same set of people instead of having it separately. So we are putting together a manufacturing

strategy and it is there. Then we will also look at EV. And what I have not mentioned to you, as we move forward over the next 4 or 5 years, it's a long-term strategy. But we have started a building block for it. It's our modular business program where you are going to introduce modularity to ensure that you are able to offer customers appropriateness in the product solution that we want to offer so he may want a different type of cabin, a different engine, different chassis for a particular use. So it will be something like a LEGO case assembly that we will do without increasing the number of SKUs at the back end. So if we have to work that out also, we are developing a manufacturing strategy. Rest assured that we are not going to miss at the moment at least when I'm discussing with my manufacturing, we are not going to miss volumes because of capacity. There could be capacity constraints in the sense for example, fuel injection pump was not available in the first quarter. And we did miss some, that was an industry-wide phenomenon because the supply was projected and then we saw some production loss, which we couldn't catch up with. While this kind of thing can happen in fits and spurts, but overall, we have the capacity that is required.

Amyr Pirani: Fair enough, sir. And sir, just one accounting question. You mentioned that one of the reasons which also led to a short-term margin impact was that a lot of the exports of the unsold BS-III inventory was done. And that happened at a lower margin than what one would have thought earlier. So was it because of the geography in which it was sent? Or was it that you had to sell it at a slightly lower price?

Gopal Mahadevan: Let me tell you one thing. The pricing was aggressive to let the inventory out. One of the things is to get the inventory out as quickly as possible. And we could have kept converting and selling, but we thought that there is so much that I can convert and sell because all said and gone, while we said that our conversion is much easier than competition because we have got EGR. And we don't have SCR system, due to which the entire exhaust outlet treatment system doesn't have to be punctured in to a new chassis, right. But the point that comes up is we want to put it behind as quickly as possible and decided that we will kind of ship it to Bangladesh or Sri Lanka where there was a demand for the BS-III vehicles and we moved it out quickly. So the pricing was aggressive. The margins were lower.

Amyr Pirani: Okay. But that's now almost done now?

Gopal Mahadevan: Almost done. I will say about 75%-80% done.

Moderator: Our next question is from the line of Jinesh Gandhi from Motilal Oswal Securities. Please go ahead.

Jinesh Gandhi: My question pertains to iEGR. So, would it be fair to say 100% of our domestic sales are now iEGR or you also sell SCR?

Gopal Mahadevan: It is almost significantly, I would say about 85%, 90% is iEGR. There are customers who want SCR, then we give SCR solutions also. Where customer prefers it for a certain applications for SCR, we give SCR also.

Jinesh Gandhi: Okay. Secondly, you indicated about overloading ban in Rajasthan and UP. Can you talk briefly about it about which are the states are we seeing stricter implementation of overloading ban.

Gopal Mahadevan: The two states where it is actually absolutely strict. In other states, they have announced it, including the state I'm talking from. But it's not really been hard implemented, but I think all of that will happen now. When that happens, it has happened in certain sectors even in Tamil Nadu and Kerala. But I think when that happens, what we will actually see is that Rajasthan and UP are very clear especially cement in Rajasthan. We just can't overload. So it's very good because what happens is tyre wear, oil consumption, vehicle fatigue, all comes off very easily. When you overload a vehicle by about 20% or 30%, the braking efficiency come down by nearly about 40% to 50%. So that's the pressure that it puts in that. One of the reasons why actually highways also get damaged because at that point, when the wheel contacts with the road, the impact is so high because of the mass that it damages the road because the road is not catering that kind of, it's not built to cater to that kind of weight.

Jinesh Gandhi: And sir, lastly on other expenses, have you seen any benefit of input tax credit being netted off from other expenses and also the NCD charge also be not recurring in this quarter because of GST?

Gopal Mahadevan: Yes. As far as expenses are concerned, Jinesh, what happened is we already have the benefit of service tax earlier, right. So we used to take the service tax credit. So the GST credit is due to other expenses because what happens is service tax was getting credited and it was getting charged, it was getting credited and adjusted with the output tax. So similarly, the input tax is getting adjusted and then we are getting the benefit in the output tax.

Moderator: Thank you. Our next question is from the line of Pramod Amthe from CIMB. Please go ahead.

Pramod Amthe: Gopal, wanted to check the EGR has been well accepted. But if you look at on the FY '17 market share versus now, you don't seem to be gaining any big traction on the other market share or any superior profitability. How would you look at it? And do we have to relook at SCR as a more aggressive solution?

Gopal Mahadevan: No. It has nothing to do with SCR. If you look at it one quarter back, everybody complimented us for our market share gain. And that kind of exemplifying that the EGR was well accepted. So believe me, there's nothing to do with EGR at all. EGR is well settled. It is accepted. Our customers are happy. The total cost of ownership is better. We have stayed away from some large deals, especially in the South and even in the West, where the prices were so far down that we said, no, we're not going to do it. It's as a simple as that. That's why we have lost share.

Pramod Amthe: So we were thinking that EGR is relatively less costlier and hence you have an advantage, which should materialize either in market share or profitability.

Gopal Mahadevan: No. EGR is less costlier. There is no doubt about that. But you see, I'm not going to pick my vehicle at a lower price and then try to discount my way. You understand? That Rs. 30,000 –

Rs. 40,000 is not going to be, I'm not going to give it away and get market share like that. It doesn't help. Then what happens is you're never a premium player. You understand. When I say premium player, I'm not playing in the same price. And believe me, I cannot take names. But suppose one competitor say, "whatever price Ashok Leyland is offering, give 1 lakh less and take it," what are you going to do? Right? So then I'm not going to say, okay, he told 1 lakh, so I will offer 1 lakh then. Then he will offer 1 lakh 25 thousands. Then I'll offer 1 lakh 30. How is it going to help us? It's not going to help us, right. So this is not about an EGR versus SCR and that somebody is going to buy because of that. If somebody wants to get a market share at any cost, well, let them because I'm not going to get over it. See, that's why I said while we are at the company level, let me tell you that we are not saying that we are not nonchalant and saying that, oh, come on, we are not bothered about volume. We are not saying that. Okay, let me be very clear. Yes, we would like to increase volume. We would like to increase our share of customers. But at same time, it has to be done with some amount of profitability. I don't mind doing a portfolio balancing. So if I get very high margins at 3718 and I have to balance it out with my LCV portfolio, no problem. If I get better margins with one customer and I have to kind of do it at lower margin with another customer, I'll do it. But I'm not going to take good margins in one order and do a loss with another customer. I can't sell it at a loss. And believe me, in this business, it's a 20%-25% gross margin, right. So if they're going to give 1 lakh more than what Ashok Leyland does, you can't make money on the deal. So then we decided that I cannot give a truck and some money to the customer. So that's not possible.

Pramod Amthe: Can you talk about how is the working capital situation in 2Q versus 1Q and your net debt position?

K. M. Balaji: Working capital in Q1 was Rs. 866 crores (12 days) and 2Q it was Rs, 489 crores (7 days). Debt equity is almost stable at around 0.3 to 1. Net debt is Rs. 2126 crores.

Moderator: Thank you. Our next question is from the line of Jatin Chawla from Credit Suisse. Please go ahead.

Jatin Chawla: This is Jatin. Couple of questions. One on the provisions that you had created for the BS-III vehicles. As you are able to sell in the export market, I'm assuming, you would be reversing that those provisions. So could you quantify the reversal of the provision for this quarter?

Gopal Mahadevan: No. When we make the provision, let me tell you that we made about 15 crores. We possibly provided another 10 crores this half year because there were some other additional expenses. So when we made the provision, we have to make an estimate. That estimate was based on this is the value that I will export. This is the cost I will incur for getting the vehicles back into my factory. This is the cost I will get for converting the BS-III to BS-IV. This is the additional revenue I'll get on the BS-IV vehicles. This is the additional revenue I'll get on selling the engines, raw engines which are there with my inventory. So, when I do that and I made a provision, it's an estimate. At that moment, when you're doing it in the first months without understanding what that whole thing is going to be, you must appreciate, we have provided I think about 15 crores or so. So, we have added possibly about 12 crores of additional

provisioning because in certain cases, engine realizations did not happen. And we have also taken a conservative view on that. But it is not like every time I do an export, I will just give a write-back of the provision. There's not been any write-back.

Jatin Chawla: Okay. Second on the GST side. There is clearly a negative impact in Pantnagar until the time the state thing comes back. But I'm assuming there will be a positive impact as well in Pantnagar because there will be some cost items in Pantnagar on which there was earlier no tax credit available and that becomes available now. Is that understanding right?

Gopal Mahadevan: No, that understanding is not right because I tell you, there are 2 parts to this. It is not a negative impact. First, I want to clarify that the Pantnagar operations are having lesser incentives, which means today, I'm getting 8.2% incentive. Ennore operations get no incentive. So to that extent, I don't multiply the realization automatically. It's a little more complicated. See, I want to share with you the perspective more than just giving exact numbers because if there are no exact numbers, each vehicle has a different price. Pantnagar still is more profitable than Ennore because we're still getting the incentive from the CGST. And we are accounting only the CGST benefit. We are not accounting the GST benefit. Now as far as the Modvat credit is concerned, you must remember earlier in Pantnagar, what used to happen, the Modvat was not available as a credit, so it was a cost. But on the sales side, there was no excise duty. So that was the realization. Today, what is happening is the taxes that you pay, the GST that you pay on an import to the state is no longer a cost because it is being taken as a credit. But at the same time, when you sell, the GST that you have to charge is no longer realization, you have to pay to the government. So the whole thing about Pantnagar having some improved profitability is not correct because whatever was the tax benefit that we get is actually VATed or taken credit for and adjusted against the output tax. After the output tax is paid out, either collecting from the customer or paying against your credit, what the central government will do, we have not yet received any credit by the way, but they have said they will and that's why we are taking a credit. They will give a refund of the CGST to the extent of about 8.1%. Are we clear?

Jatin Chawla: Yes. No, the confusion was this 30 crores impact, I think, that was quantified in one of the questions earlier.

Gopal Mahadevan: The reduction in margin.

Jatin Chawla: So, it has led to that impact.

Gopal Mahadevan: Realization net-net was 13% better. Now it is only 8.2% better. Net-net after factoring in all the tax credits.

Moderator: Ladies and gentlemen, that was the last question. I now hand the floor back to Mr. Annamalai Jayaraj for closing comments. Over to you, sir.

Annamalai Jayaraj: We thank all the participants. We thank Ashok Leyland management for sparing time for the call and also providing this opportunity to host the call. Have a good day.

Moderator: Thank you. Ladies and gentlemen, on behalf of Batlivala & Karani Securities, that concludes this conference. Thank you for joining us and you may now disconnect your lines.