“Ashok Leyland Q1 Financial Year 2019 Earnings Conference Call”

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Moderator: Good morning, ladies and gentlemen. Welcome to the Ashok Leyland Q1 FY2019 Earnings Conference Call hosted by Motilal Oswal Securities. 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 "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I will now hand the conference over to Mr. Jinesh Gandhi from Motilal Oswal Securities. Thank you, and over to you, Sir.

Jinesh Gandhi: Thank you. Good morning, everyone. On behalf of Motilal Oswal Securities, I would like to welcome you all to 1Q FY 2019 Post Results Conference Call of Ashok Leyland. Ashok Leyland is represented by Mr. Gopal Mahadevan, President and Chief Financial Officer; and Mr. K.M. Balaji, Vice President, Corporate Finance.

I would like to thank the management for taking time out for the call. We will start the session with the opening comments now by Mr. Gopal. I will now hand over the call to Mr. Gopal Mahadevan.

Gopal Mahadevan: Good morning, everyone. Thank you very much for being on this call, and thank you very much for the interest in Ashok Leyland. I will quickly summarize the financial performance and hand it over, because I am sure there are a lot of questions on the new axle norms, and I would want to have that discussion and answer questions that you have.

So, overall, the industry has grown smartly at about 84% to 89,386 units. Of course, this has been on a low base of last year. But even with that low base, I think the industry growth that has happened has been satisfying.

Ashok Leyland has grown a tad lower than the industry but has grown judiciously if I may use that term, because, as you know, we were clear that we would not want to get into unprofitable deals. It is not that we do not want to grow. Let me assure you that the medium-term strategy of the company is to grow at the same rate if not faster than the market. But you are going to see quarters where, sometimes if we do not participate in the market because of heavy discounting, it is because we also want to ensure that we maintain cash flows and profitability.

So yes, we have also shown a healthy growth of 60% over same quarter last year. Our revenues have grown at 47% to Rs.6250 Crores and our PAT has grown at 233% to Rs.370 Crores, and our EBITDA has been 10.4%.

Just wanted to share with you that this is the 13th quarter out of the 14 sequential quarters where we have had double-digit EBITDA. The cash on the balance sheet, net cash is Rs.1165 Crores, so we continue to be cash positive, as you know, as we move.

Other than that, we raised prices in April, possibly the only player to do that because raw material prices are increasing. We have also tried to astutely change the mix of the vehicles to ensure that our profitability is maintained.

And our overheads continue to be in control. This is something that we have been doing continuously. Invariably, everybody has a question as to how much more can you squeeze out of this? Well, things can only get better so we have to be good at this. I mean, and we are getting better and better at this. And we need to do that.

So, I am going to leave with this brief introduction. And of course, we have had this new axle norm being announced by the government a couple of days ago. So, there are, I think, positives, negatives and neutral aspects also to these norms, which we can discuss in the call going forward.

So back to you, Jinesh.

Moderator: Thank you. The first question is from the line of Ashwani Kumar from Reliance Mutual Fund. Please go ahead.

Ashwani Kumar: Good morning. I have two questions, basically. One, is there a new truck required for this, which will conform to these new axle load conditions? Second, you have, let us say, in terms of your end usage, is, nearly 200 types of end customers use trucks, ranging from engine oil tankers to cement players, coal players, water transportation companies and many other end users. Some of these are volume-led in tractor-trailers, for example, the trailers; the steel company use it, and the tyre companies or, for example, the tool companies. So, there is one issue of dimension. And second issue is offloading. So, one is the physical volume where, even if there is a 20% excess load there, unless and until you really modify the vehicle, you cannot load extra because it is a volume constraint thing. So, what part and proportion of the industry out of these 200 types gets impacted by this regulation? That is one. And what is this concept of new trucks, which is required for this specific thing? These are the 2 questions, which I have.

Gopal Mahadevan: Thank you, Ashwani. I think it is a good question and that gives me an opportunity to clarify. I am going to go a little broad-based and also clarify so that the same questions do not come up again. Wonderful question from your side and I am going to just step back and tell you that, yes, the new axle norms have come in, and it could have been better if the government had consulted the industry for the launch date of these norms. Because then you have had a plan to kind of comply with these norms. By the way, these norms are one of the highest in the world. If not the highest, and we are even higher than the U.S. as far as the axle weights are concerned now, I mean, the GVWs are concerned now. Why the government has chosen this level of weight is not clear because the road conditions, while they are getting better, are not as good as what we have in the west. My answer is going to be slightly longer because I thought this is not just a question that I want to answer for Mr.

Ashwani Kumar but for the larger set of investors who are also there on the call. So, this is one part. The second part is, so there are 3 aspects to his whole thing that I want to touch upon. One is applicability. The second one is impact. The third one is readiness. As far as applicability is concerned, whether it is going to be prospective or retrospective? If it is prospective, things are better for the industry as well as the country, because we can get the vehicles ready. Of course, we have not much time because the norms are already applicable. But these have to be approved, and then the vehicles will get rolled out. If it is retrospective, frankly, somebody had bought a vehicle from us just about two days ago. We cannot say that, "No excuse me, now you got a 20 tonner, now you can actually go and load 24 tonnes." I mean, it is not as simple as that because while there is overloading, which is happening and India is predominately still an overload market where everybody talks about greater load, it is not happening everywhere. Yes, so this is to be done judiciously. But if it is done retrospectively, one of the most important things that we have to be careful about is the impact it will have on safety. Because suddenly, you are opening the gates and people will start further doing overloads where it is not safe. There is volume There is weight. There is impact. There is center of gravity. It is a whole bunch of stuff in a vehicle that we have to look at before we start overloading. So, the vehicles have to be engineered according to the spec. Now hopefully, these are not going to be applicable retrospectively, but we will have to wait and watch. Now the second one is impact. You had rightfully said, is that the impact is the way to look at it, and if I were to cut this industry very broadly, that is tippers, then there is ICV, then you have got cement bulkers, oil tankers, scooter carriers, car carriers and a lot of other applications which are volume-based. Merely tippers and ICV segment alone will account for roughly about 41% of the total nearly 41% of the total industry volume for the first quarter itself. And if we were to add that the scooter, car carriers and bulkers, etc., I think another 10% will go. So, you have a situation where 50% to maybe 60% of the volume will not get impacted because of the new regulation. And secondly, in tippers which is overloaded segment, if the government is going to say that "No, I am going to increase the axle load norms which are GVW norms, but I am also going to ensure that I monitor it very strictly," then actually we can see the possibility of tipper demand actually going up. Because if they are going to be extremely strict, then the tipper guys would have to buy more tippers, right? So that is what I said. Not all of this is gray, and I do not think there is any necessity for panic. I will also come to the panic piece of it, not because I am in the truck industry but because we have seen the commercial vehicle industry over the last few years and how things have panned out. The last aspect of it is readiness, which you asked. Yes, is this a new truck? It is not a new truck, but is it the same truck as an old truck? It is not so. For example, predominant part of the industry actually works on a tyre, which is called a 10R20. But that is not going to work under the new norms. So, we have to have higher tyres, what is called 11R20, there is tyres, which are called as 295 sizes, they may be tubeless if you were to go for heavier weight applications. The tyre industry also has to be ready, right? So, I actually see multiple types of tyres being fitted on the same vehicle to have various GVWs. Secondly, there are things that we may have to change depending on, again, like this is one hour call I cannot give a breakdown, but we also reviewed, there will be impact on steering, there will be impact on transmission. There could be impact on chassis. So, we may have to put additional features. So, the vehicle will be different. Is it totally different? It is not totally different. But these modifications will take time. It is not only for us. It is for everybody else. And then after that, we have to get the CMVR approvals. That will take about 3 to 4 weeks. So, the government, while it has announced it, has announced it immediately is surprising because there is a process that has to be followed, if you want to deliver vehicles, which are going to be compliant, with the new GVW norms and which are going to be safe. Now coming to the panic bit of it. The panic bit of it, I am saying we have the same kind of panic and I appreciate the concern that investors and analysts are showing because, obviously, they would like to know to bring a certain amount of certainty to something that has kind of shaken the pot over the last couple of days, but if you look at the BS III to BS IV, when it happened, it happened in exactly 48 to 72 hours. Well, there was a short-term impact, but things stabilized immediately. Similarly, when GST happened, people were very concerned that this is going to increase productivity by 15% so that the truck demand will come down by 15% because of GST demand. At that point in time, I remember sharing my views, and I was right, not out of pure wisdom but logic more than anything else, because I said that if there is anything that is going to be more productive, you would see more investment coming, and then that is what happened. And the industry, which was a negative in September last year, grew to a 14% positive for the full year. Now here of course, this year, we have started with a huge 84% positive. But yes, if this is something that could have been done better, certainly, it could have been done more conservatively. It could have been more planned. The impact could have been looked at, and then sectors could have been addressed. But well, it has happened. So at the moment, all I would say is the reaction that we are having from various constituents is possibly a little more worried than we should be. At the same time, I am not saying things are all hunky-dory, but I think there are both positives and negatives that will come out of it provided the government is going to enforce the norms clearly. It is a long winding answer, but I thought I would give a larger answer for Ashwani's question.

Ashwani Kumar: Thank you.

Moderator: Thank you. The next question is from the line of Hitesh Goel from Kotak Securities. Please go ahead.

Hitesh Goel: Thanks for taking my question. Gopal, basically just touching on this point again. First, what I wanted to understand is that what is the actual in your view, or you have any data or sense on what is the overloading happening across India? And if you can break down across North and West, what is the kind of overloading you see? Anecdotally, I guess because you have got your own data. That is first. And secondly, also, when the government is going to come up with the regulation for scrappage, because year afterwards like you said many old trucks may not be able to comply with the latest regulations. So, will it also lead to a situation where they come with a scrappage policy in the next few months or in next 6 months?

Gopal Mahadevan: I do not know. I think the scrappage policy particularly may come in 2020-21 That is what the government had announced. They would want to do it along with the introduction of BS VI norms, and that would help the industry because, immediately after the BS VI pre-buy (that also happened for BS IV when the norms came in) that year possibly, the introduction of scrappage will possibly see 200,000 to 300,000 vehicles coming into the demand market, which will help the industry. As far as the overloading norms in the country are concerned, it is very difficult to estimate because you know there are sectors, subsectors, and there is no official data available. But our guesstimate is the overloading starts anywhere between 20% and 40%. So, they are kind of formalizing arrangements which are already there. So, I do not think that there is going to be severe depletion because it is not like we are a strict rated load country and everything is going as per rated load and suddenly the load is getting increased. Everybody is reacting like that. It is not so.

Hitesh Goel: And would it be fair to say that overloading is not the same in North and West, as in the South. Is there regional disparity also in overload?

Gopal Mahadevan: Yes, I would believe so. That is what the industry pundits keep saying that in South, the loads are more rated than towards overload, maybe 60:40 is the ratio of rated. Whereas, in the North, it is more towards the same ratios more towards overload. So of course, there was again a lot of worry when UP and Rajasthan, the overload, the rated load norms were loosened a little bit. Again, at that point in time, not to sound defensive, you folks know it, if there is something that needs to be shared, we will share. But at the same time, if we look at it, UP and Rajasthan volume and the impact of the rated load removal was not very significant on the overall volume of the country for total industry volume as well as for Ashok Leyland. Here, the norms I would say is that are only going to if what we hear and what the analysis that we have and believe me, I have failed to mention the most important thing. The revised GVW norms are based on a study of that is what the government says, of 10,000 vehicles. And we have found that overload is predominantly there and that is how they have increased the norms by about 20%. So, you are going to formalize a practice, which existed now, if that is the case. So that is why I am again saying, if there is strict implementation on the overloading, and this government is known for strict implementation. I think net-net it will be favorable for the industry.

Hitesh Goel: Okay. Just a final question on this point, I just wanted to understand the investor concern also on the is it basically like Maruti's and HUL's, they have a specific requirement of trucks, right, in which they want fleet to carry load. Does that change with this regulation, all the predefined specifications on the trucks that they can carry? So, I would believe we will be looking at?

Gopal Mahadevan: Maruti's, Hero Hondas and HUL that is what I mentioned. The car carriers, truck carriers, cement bulkers, oil tankers are all based on volume. So, you cannot have over-dimension. You cannot have a truck and say I will have over-dimensional cargo. In fact, the government has come heavily on over-dimensional cargo, and that is why the motorcycle carriers and car carriers had to reduce the volume of the entire cargo and reduce the number of vehicles that they can carry. So, in our estimate at the moment, this is not going to impact much. That is why I said, if you look at tipper, if you look at ICV, if you look at volume-based segments like bulkers, cement bulkers or oil tankers or truck and I mean, 2-wheeler and car carriers, I do not think that, that will form over 50% to 60% of the total industry volume. I do not think that the revised GVW norms are going to impact them at all.

Hitesh Goel: Thank you very much.

Moderator: Thank you. The next question is from the line of Ruchit Mehta from SBI Mutual Funds. Please go ahead.

Ruchit Mehta: Just extending this subject. Would you need to also upgrade some of the engine capacities, particularly at the higher end or wherever the maximum delta in the load weight has happened?

Gopal Mahadevan: I do not believe so. See, we may have to make some adjustments to torque, etc., if it goes really tops. But I think the predominant view, when we had the discussion internally, was that, more than the engines, it is going to be the tyres, the drive train and the chassis that will need adjustments, not the brakes also. Not the engine purely.

Ruchit Mehta: Okay. So, from today onwards, right, I mean, logically, any buyer of a truck would not want to buy any truck because effectively, in a few weeks or a few months' time, he would get a truck which maybe is, what about 5%, 10% extra cost but 25% higher payload. So, do you see in a phase where you need to really sort of crank out all the products as fast as possible with the new norms? And how fast can we get the entire fleet be re-promulgated to the new standards?

Gopal Mahadevan: Well, I expect the following: I think short term, in a month or two, I do not know whether it is a month or a month or two because we have to get clarity on the norms. The government is still not clear whether it is retrospective or prospective and exactly how the certification process is going to happen. If I were an average fleet operator, I will say, "No, let me just hold and not buy the truck now." So, you may see it. But whether that will happen and whether it is going to happen in across segments, I have my doubts. So, what we will see happening is that the tippers may continue to grow because it is an overload segment anyway. But there are certain sectors like 3718 where things can slow down a bit before they pick up again. Once the CMVR approvals come and everything starts moving, no. Then after that, it becomes easier, yes.

Ruchit Mehta: Okay. But what is the time line for your promulgation? I mean, for you internally to get the product ready and then to give it to the ARAI to promulgate, I mean, from scratch, what is the timeline? What are we looking at?

Gopal Mahadevan: That is what I said. It will take about 3 to 4 weeks.

Ruchit Mehta: 3 to 4 weeks. Okay.

Gopal Mahadevan: That is standard ARAI timing approvals.

Ruchit Mehta: Okay. And just one clarification. You mentioned a couple of times that you are not sure whether this is applicable retrospective or not, but there is sufficient social media posts, including from Dr. Gadkari are talking about that you know, they cannot monitor this on the existing fleet and why not let them also allow to have it be higher loading, so is that sufficient?

Gopal Mahadevan: Can you repeat your question? Please I am sorry, I missed it

Ruchit Mehta: I'm saying a couple of times you have mentioned on this call that you need clarity on whether these new norms are applicable retrospectively or not.

Gopal Mahadevan: Yes.

Ruchit Mehta: But since yesterday evening, there has been quite a few posts on online or on the newspaper, etc., where Gadkari has talked about that why not allow the existing fleet operators to also benefit from this? Is that enough clarity for you? Or are you still need an official notification on this matter?

Gopal Mahadevan: You see there are two people who have to get clarity on the subject, two sets of people. One is the existing fleet owners and the second one is the truck manufacturers. It is more important for the existing fleet operators because based on this, if they start doing overloading. And if there are either physical damages to the vehicle or there are safety issues, there is a challenge, right? The second one is we cannot go by newspaper or press reports. So, we will have to wait, we need to have clarity on this because if the existing fleet operators are going to be allowed to do it, I mean, existing trucks can be allowed to get onto the revised axle norms, we really need to understand how are they going to get certified? Or are they not going to get certified? If they are not getting certified, why should new vehicles be certified? Then you do not require to be certified at all. It defeats the purpose of a certification, right? So, I really do not know. See, that is why I said, there are certain aspects of it where we are not clear, how is this going to happen. That is why I said if the Truck manufacturers had been consulted, we could have clarity on this implementation, right? Otherwise, it is still possible that somebody will buy an old truck and then say that, "No, I will load the 25% on it." That is also possible. So hopefully, the government is hoping because initially what the government said is, it is only prospective. Now there have been newspaper reports, but I would prudently wait for a circular from the government because they are not formal systems of communication.

Ruchit Mehta: Thank you.

Moderator: Thank you. The next question is from the line of Anupam Tiwari from Axis Mutual Funds. Please go ahead.

Anupam Tiwari: Thanks for the opportunity. Good morning. Just wanted to ask if you read the notification, it says very clearly, that it is prospective, so there should not be any confusion on it because the GVW has to be lowest of notified by the government or as declared by truck manufacturer, right?

Gopal Mahadevan: Yes.

Anupam Tiwari: But it is certified. So, from that perspective, legally, very clear that it only prospective. Now my question is that if you have to now start getting into a regime of new models, high-end GVW and you said that 3- to 4-weeks is required for designing the product.

Gopal Mahadevan: Not designing, for approving the product.

Anupam Tiwari: Okay. How much time it will take for you to design the product and doing whatever minor verification you need to do?

Gopal Mahadevan: It depends. That is why it is a difficult process. It may take 2 weeks. It may take even 3- 4 weeks because it really depends on what is the impact that we are having on the tonnage in each of these axles. The very large vehicles will take a little more time, whereas, the smaller vehicles, with the MDVs, will possibly be done faster. So, I think we should expect that anywhere between 4 and 8 weeks is what will take for us to sort out. We have to of course look at tyre vendors, they should be ready with the tyres. So, if they are saying that they do not have the tyres, there is no point in putting the existing tyres and changing the spec. Maybe the government may allow it. So, we are still talking about an uncertain animal. There is no doubt about that.

Anupam Tiwari: Look, let us forget government or any other aspect. If as a manufacturer, now you want to say that, okay, we were selling a 16-tonner or a 37-tonner. Now let us say for example 16-tonner now becomes a 19-tonner. Then you need to design them officially, which can be certified with your standards as a 19-tonner vehicle. With everything being done, what would be the timeline, when would you be ready for production, commercial production?

Gopal Mahadevan: That is what I said, 4 to 8 weeks.

Anupam Tiwari: 4 to 8 weeks. So, it is fairly a short time. It is not a very long time to take? And how now in this situation you will ascertain demand?

Gopal Mahadevan: No, that is what I am saying. You are trying to bring in absolute certainty to an uncertain process because, if we say now that the existing tyre sizes will be allowed for the higher loading because ultimately, we have to get the approval. My dear friend. So, we will know only when we test the waters. So, suppose that it is not happening, then it is not 4 to 8 weeks. I have to go back to tyre manufacturer they should have the molds for it. They should have the capacity for it. It is not just an Ashok Leyland problem. It is an industry problem. Then maybe it may take 3 months also for a particular type. I do not know. So that is what I am saying. See, it is just 48 hours since the notification has come. So, in 48 hours, I cannot really say that, in 4 weeks, I will get it or in 8 weeks I will get it. It is an assumption that between 4 to 8 weeks, we can close the matter for a predominant part of the vehicles.

Anupam Tiwari: Now second question is maybe it is slightly weird and kind of not very sure how to answer it. But now in this new environment, how you will do demand forecasting? Because the inventory management will become important. Let us say there are minor changes in the kind of vehicle that you want to produce. So, which one to produce: 16-tonner, 19-tonner. Which model to produce? Would it be too difficult and your inventory level will go up?

Gopal Mahadevan: See, I will tell you. It is not a weird question. It is the most practical and insightful question. I am sharing with you, so we are producing certain types of vehicles. We are not producing certain type of vehicles now, and we have to ensure that we are able to what should we say, ensure that inventory pileup does not happen because certain vehicles do not get picked up. So, we have to look at multiple options when you are doing it, and demand forecasting will happen only from the ground. So, our guys will have to stay closer to our dealers and with our fleet operators as we speak, we are getting in touch with larger fleet operators, getting their insights into this what they feel about it because they may have a completely different view on this entire modification, right? So, I think a lot more clarity will come a week from now.

Anupam Tiwari: And Sir, last thing from my side. If possible, is there an upgrade possible for, let us say, with minor changes from an existing 16-tonner to a 19-tonner?

Gopal Mahadevan: Can you repeat your question, please?

Anupam Tiwari: Is there any upgrade possible at factory level from, let us say, an existing model, which is a 16 tonner, which moves to 18-tonner or 19-tonner?

Gopal Mahadevan: Yes, an upgrade will happen. It is not that we are going to produce a new vehicle. See we will have to look at wheelbase. We will have to look at the tyre size. We will have to look at the steering. We will have to look at the chassis. If there is a flitch required, then there is something call it a flitch that we may have to put on the chassis.

Anupam Tiwari: Thank you. Thanks a lot, and all the best.

Moderator: Thank you. The next question is from the line of Prateek Poddar from ICICI Prudential. Please go ahead.

Prateek Poddar: Just taking a bit from the axle load question. Two questions. One is, could you just talk a bit about the competitive intensity? And when I look numbers, I am not sure, but there is some loss of market share for Ashok Leyland. So where is it you draw the boundary line and you say because others can be irrational, where is it where you draw the boundary line, and say, you know what, now market share is more important to me than profitability? Is that something in your mind as of now? Could you just talk a bit about that? Thanks.

Gopal Mahadevan: You are correct. We have to balance between cash flow, profitably and market share. So, we have lost market share of about 4.5% in the current quarter. Our market share for truck and bus put together is about 30.%. But what has happened is we have gained in bus market share. We have gained by 4.5% of our market share, and is 40.9%. And market share in truck was 28.5%. We are 5.3% lower than same quarter last year. But that reason was because the make of it, the weight of truck is heavier on the overall mix. Having said that, you see the basic point comes like this. There is market share, there is revenue, there is profitability and then there is ROCE and there are cash flows. What we will not do very clearly is we will not do a deal where we do negative margin, first. I am not going to sell anything below variable cost. It does not make sense, right? So that is something that we will not do. Between gross margin that is on variable cost to a standard level of gross margin, we will take decisions based on the criticality of the customer and the volume. So, I am not going to chase the ones and twos with very, very low pricing. Does not make sense at all. You will only discount your way and you will set that lower hurdle rate for yourself as we move forward. And then the third thing we will do not do is credit push. We have not pushed the stock into the channel. We possibly will not do it because, if we had pushed it, I could have gained some market share by selling more and do not bother about the retails. We have a close eye on the retails also. See, that has helped us in times of difficulty. We looked at it when the whole BS III to BS IV shift happened. We got off with negligible impact because we had not pushed inventory into the channel. Now so if you ask me, are we not focused on market share? Of course, we are focused on market share. Otherwise, how do you think as a company, were have moved from 24% to 34% market share over the last 6 to 7 quarters? We have been investing in network. We have been growing the network disruptively. We have been adding layers and layers on it, which is low-cost layers into the network, so we will continue to do that. There are multiple ways to do this. So, we have to ensure that the market share bit is not just on discounting but also on other total cost of ownership. So, we are working on that. Yes, if it goes below a certain point, we may say, okay, let us readjust our gross margin levels and look at gaining some share. But at that point in time, well, our profitability can be sacrificed. It is possible, so then we have to look at how to augment the EBITDA margin for that quarter or for that particular period by this I mean managing cost, also which we are doing. So, there is no secret saying, “If I do this, I will get this.” So, it is a confidence factor. And typically, with the other challenge we have, this industry operates on a month end. That is frantic activity. So, we take some dynamic decisions at the end of the month. But while we noted that we have lost about 4.5%, we believe that we should be able to gain it as we move forward.

Prateek Poddar: Understood. So, by the year-end, I mean, your intention would be to gain back some of this? I will say this quarter or whatever market share you are at, that would be the lowest, is that what?

Gopal Mahadevan: Let us hope so. I do not give out outlook, but let us hope so. Let me put it this way. Our interest is not we do not have discussions saying, "Okay, let us look at profits, guys. Do not worry about the market share." No, no. We say, "Our market share is this. So how do we get this back? Oh, is this what we have to do? Can we do this? Okay, we would not do this. And how do we gain the market share back?" So hopefully, you will see that our market share will move northwards.

Prateek Poddar: Great Sir. Thank you so much and all the best.

Moderator: Thank you. Our next question is from the line of Shyam Sundar from Sundaram Mutual Fund. Please go ahead.

Shyam Sundar: Thanks for the opportunity Sir. Sir, in the LCV segment, more than the 6 to 7.5 tonne segment, will the revised norms be applicable? Of course, this is a very small segment in the overall?

Gopal Mahadevan: I do not believe so. We are waiting for clarity on that. I do not believe so.

Shyam Sundar: Okay, Sir. And in this quarter, are the LCV subsidiaries fully consolidated in the results? How is the EBITDA margin performance in the LCV business currently?

Gopal Mahadevan: Can you please repeat your question?

Shyam Sundar: Sir, the LCV business the Nissan joint venture, the erstwhile Nissan joint venture. Are they fully consolidated in this quarter?

Gopal Mahadevan: No, we do not publish consolidated results. The results are standalone.

Shyam Sundar: Standalone? Okay. So how is the margin performance in the LCV business now, Sir?

Gopal Mahadevan: I think the LCV business has been doing very well. If you look at last year, the full year PAT, we have actually become PAT positive in the LCV business. Doing very well, the gross margins are better than the M&HCV business. I think this is the business which seems very, very positive for us, doing great and it is the smartest turnaround that we have seen. Both LCV and Foundries which the markets were worried about, are doing exceptionally well. Foundries for the last quarter, did 5%

EBITDA. I mean, last year, we had a 5% EBITDA, a far cry from the negative EBITDA that it was posting. So, LCV business also has become completely profitable at PAT level, not just EBITDA.

Shyam Sundar: Okay. Sir, we are seeing a very sharp increase in commodity prices. But if we see the gross margin performance has been very strong this quarter. So, is there an element of mix in terms of maybe difference in spares this quarter if you can throw some light on that, Sir?

Gopal Mahadevan: I think our aftermarket has been growing at nearly 26%, which is very good. I think last year; the full year was about 34%. But we have seen the aftermarket in the current quarter growing at about, I think about 26%-or-so. So, it has been a good growth. Our exports are forming roughly about 9% of our revenues. That has posted again I think about nearly 22% growth in our revenues. And LCV, of course, had gained market share. It has moved from 15% to 16%, posted a 35% growth. What else did you ask for? So, I think most of the businesses have done reasonably well.

Shyam Sundar: Yes. So, what would be the mix of defence this quarter, sir, as a percentage of revenues?

Gopal Mahadevan: Defence today. I mean, this quarter was not very high. It was hardly about 3% to 4%. Typically, it is about 6% to 7%.

Shyam Sundar: I will come back.

Moderator: Sorry to interrupt, Mr. Sundar. Sir, may we request that you return to the question queue? The next question is from the line of Sonal Gupta from UBS Securities. Please go ahead.

Sonal Gupta: Good morning Sir. Thanks for taking my question. Just continuing with the same, I mean what was the share of domestic trucks and buses in revenue, for the quarter?

Gopal Mahadevan: Domestic truck. See, we do not actually completely give a complete breakdown but let me give this. Our truck revenues were roughly about 62% of our revenues. Bus was at 8% at over 9% to 10%.

Sonal Gupta: Okay. And sir, just in terms of what is the capex that we expect for this year and next year, I mean, given.

Gopal Mahadevan: Well, at the moment, we will take it year by year. But I think this year we possibly will go to a max of over Rs.1000 Crores, predominately into LCV business, which I talked about earlier in the previous quarter also. Then, the second we have is in electric vehicles. The third one is we continue to invest in the modular vehicle program, which is very important. And then you have residue capex also. I think our manufacturing will require a lot of debottlenecking, and so we are doing on that residue capex also. So, overall, I think it will be about Rs.1000 Crores.

Sonal Gupta: Thank you so much.

Moderator: Thank you. The next question is from the line of Dharmendra Singh from Axis Mutual Fund. Please go ahead.

Dharmendra Singh: Sir, I have a question on your BS VI, which you have done recently tied up with Hino. And you have a successful on BS IV with your EGR technology. So, going forward, will you change the technology to SCR? Or will you remain on EGR and you work on it? And because of this, what do you see are prebuying and where you see the sale will come to us because of scrappage?

Gopal Mahadevan: Okay. You asked 2 questions. One is about BS VI strategy, second one is on scrappage. So, let me answer. The BS VI, ultimately, the level of NOX and emissions that we need to have for BS VI would require SCR technology. We cannot do it with EGR alone. You are right, up to BS IV we can do that. But at BS VI level, you would require selective catalytic reduction because what you require is, after the engine manifests, you would require a diesel oxidation catalyst, then we have the other EATS boxes as we call it, exhaust after treatment systems. And then, you have the selective catalytic reduction urea dosing that is required to ensure that the NOX emissions are significantly reduced. So, we have our subsidiary company called Albonair from which we can source the urea dosing systems and then we have tie-ups with other companies for the EATS, the exhaust after treatment system. So, we are very much on track on the Euro VI.

Dharmendra Singh: And on the scrappage, Sir?

Gopal Mahadevan: Scrappage I think is expected on 2020-21. That is what the government is saying. And that is a good timing because what happens is immediately after 2019-20, we are going to hopefully see a lot of prebuy for Euro VI. So, when that prebuy happens, Euro VI and then 2020-21, will see a little bit of a reduction in demand because there will be an exhaustion after the prebuy. At that point in time, if the scrappage policy has come, then that should introduce about 200,000 to 300,000 units into the market.

Dharmendra Singh: Sir, because of this BS VI, do you see a heavy prebuying or it will be a standard one, it is happening BS IV?

Gopal Mahadevan: I do not know, but I expect the prebuy to be quite heavy, because the vehicles will become costlier.

Dharmendra Singh: Thank you.

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

Ashish Nigam: Just a clarification, Gopal. This Rs.1000 Crore capex, is only capex or it is capex plus investments?

Gopal Mahadevan: I think it should be able to fit in into investments also. We will have to see whether we will have to put some residual investments in Optare because Optare, if you notice the Chairman's statement, is very important and is on the verge of a turnaround. See, I think we just wanted to take this. We have turned around a lot of businesses. So that is important. Even as we grow market share over the last 4 years, 5 years, if you look at it, our market share has grown nearly about 10% over the last 6 years-or-so. Our network has grown from nearly 300 points of presence to nearly about 3,200 points of presence. We have launched a state-of-the-art product, and we have also impaired a lot of investments and have walked out of certain things, acquired the LCV JV from Nissan, closed the John Deere JV. Impaired Optare, but we are fixing Optare. We have merged Foundries and which is now successfully turned around. So, we are doing the same thing with to Optare. So Optare may require some funding. We are not too clear how much at the moment, but is it going to be huge money? I do not think so, maybe about GBP 6 million, GBP 7 million, GBP 8 million. We expect that 1,000 Crores will take care of that also. Other than that, we are not seeing any major funding fusion actually happening in the subsidiaries at all. In fact, we are also eagerly waiting for the timing of the Hinduja Leyland Finance Limited (HLFL) IPO. There is a price discovery. Because you do know that all investors know that HLFL shares are valued in the balance sheet at a significantly lower amount.

Ashish Nigam: And these 200,000 to 300,000 trucks which come up on the scrappage, you are talking about 20-year-old trucks or is it 15-year-old trucks? How are you seeing that?

Gopal Mahadevan: I will tell you, to be candid, beyond 15 years is not that much of data. Even between 10 and 15 it is not. So, whether it is 15-or-so, I think that these numbers will remain. If it is just scrappage, that would not help. It will help if there is an incentive for scrappage with the government saying that they will give a rebate on GST. They are going to give an incentive of Rs.1 lakh or Rs.1.5 lakh. At that point, someone would say, “Let me know now dump this old tuck and get a new one because it makes financial advantage for me.” I just put myself into somebody's position and say, “What would I do if I were to do that?” I would say, “Yes, I would sell my truck because I am getting financial advantage out of this.”

Ashish Nigam: Thanks so much.

Moderator: Thank you. The next question is from the line of Basudeb Banerjee from Ambit Capital. Please go ahead.

Basudeb Banerjee: Thanks a lot for taking my question. So, a few things. One in this quarter's numbers if I see almost Rs.928 Crores of inventory reversal in the line item? Can you explain that, Sir?

Gopal Mahadevan: Rs.928 Crores of?

Basudeb Banerjee: Inventory reduction?

Gopal Mahadevan: In this quarter?

Basudeb Banerjee: Yes.

Gopal Mahadevan: There is no, I do not know. Where is that?

Basudeb Banerjee: In the expenses line item that you see, the changes in the inventory?

Gopal Mahadevan: Oh, you are talking about in material cost?

Basudeb Banerjee: Yes Sir.

Gopal Mahadevan: That is part of the material consumption because what had happened is you have the raw material purchased and the net changes in WIP. So that has come as part. I will just request Balaji to take this question.

K.M. Balaji: Rs. 928 crores reflect the change in inventory due to increase in inventory of Finished vehicles from 2500 units in March'18 to about 7850 units in June'18, as well as the increase in RM and WIP.

Basudeb Banerjee: So, taking forward that gross margin like in this quarter where raw mat expense for the overall industry moved up discounting was also more or less static for the industry mix wise also nothing much of a change so any specific reason why the gross margin shoot up so much significantly and how?

Gopal Mahadevan: No, the gross margins have changed because of the mix that has happened. You see from last year onwards what has happened is especially the second half the tipper volumes have started to go up the higher tonnage vehicles has started to go up.

Basudeb Banerjee: Sir if I look at sequentially because the whole higher tonnage product mix increase already was there for second half of the year.

Gopal Mahadevan: Yes.

Basudeb Banerjee: So, on a sequential basis it has moved up significantly.

Gopal Mahadevan: No, the other thing has been there are two other reasons one is also we have taken price revisions so the impact of price revision start coming in like for example when I do a price revision in the month of January or later part of it, the impact of the full price revision start coming in the month of April, May, June and similarly we had another additional price revision happening in the month of April 1.

Basudeb Banerjee: But your blended ASP on a sequential basis in fact is slightly lower and mix?

Gopal Mahadevan: ASP may not reflect the exact reason for the movement. There has also been improvement in LCV profitability.

Basudeb Banerjee: So, like now your LCV scale is almost about 4000 per month at what level one can expect that your LCV margin will be better than your rest of M&HCV portfolio margin because it is also function of operating leverage?

Gopal Mahadevan: Can you just repeat your question?

Basudeb Banerjee: Sir, at present levels of scale of LCV at 4,000 per month, at what level of that run rate one can expect that the operating leverage will be good enough to make the LCV margin at par with this top portfolio or even better than that?

Gopal Mahadevan: LCV margin is as good as the current portfolio margin. We have already accretive to the overall results.

Basudeb Banerjee: At EBITDA level, it is at per month in with the rest of portfolio.

Gopal Mahadevan: At EBITDA margin, we are almost close to the rest of the portfolio and at 4500 levels, will be even better than that because compared to MHCV, LCV is small and the investments are also small. The investment that we have done on the LCV business is depreciated now. And the gross margins are better than the heavy commercial vehicles. That is why I said it is a very smart turnaround that has happened and the cost are lower due to operations with slightly less smaller set of people. So, while the revenues are on Rs.2500 Crores per annum, the margins are getting now better.

Basudeb Banerjee: And last question Sir like after the Pantnagar addition, there has not been any major capacity addition so as we will be reaching almost to full utilization in the M&HCV for 180000 volume in next two year’s time so when do we see the next Greenfield M&HCV capacity addition when can the capex start?

Gopal Mahadevan: I do not think we will have any large Greenfield additions.

Basudeb Banerjee: Because as you saying the scrappage policy, 2 lakh plus demand coming up from FY2021 then you might run short of capacity by then?

Gopal Mahadevan: No, but not in all segments. For example, in my chassis capacity, I do not see. See that is why I said this is a little more complex. Your question is interesting, but we are also looking at modular vehicle program where we are going to bring in commonality of parts. The second thing is we may require like for example there was a paint capacity that we need to increase which we have done. And similarly, we may require something in rough machining, which maybe added. So, we are continuously on debottlenecking plus we require facilities in cab facility and bus bodybuilding, which we have done. For example, the Andhra facility we are putting up a bus body building there, bus assembly not bus body building alone but assembly facility there, so we will continue to debottleneck but you are not going to see some single shot 3000 Crores of capex anywhere.

Basudeb Banerjee: So theoretically with 180000 M&HCV capacity, at best on debottlenecking, how much one can assume that can move up potentially because of all these activities?

Gopal Mahadevan: I think we can go to up about another 10% to 20% more excluding LCV.

Basudeb Banerjee: That is 200000 to 220000 without much of capex.

Gopal Mahadevan: Yes.

Basudeb Banerjee: That is great.

Gopal Mahadevan: I am saying without much significant chunky capex like 2000 or 20000.

Basudeb Banerjee: Sure, we are around 400, 500 Crores.

Gopal Mahadevan: For a company of this size I am telling you which is including new initiatives like LCV because we are now going to refurbish. The Dost is seven years old and if you look at electric vehicle, this size of capex is normal.

Basudeb Banerjee: Surely Sir with the kind of working capital reduction and free cash flow generation we have witnessed, the Rs.1000 Crores of Capex per annum would not be that much impact on this?

Gopal Mahadevan: Yes.

Basudeb Banerjee: That is great. Thanks.

Moderator: Thank you. The next question is from the line of Achala Kanitkar from Birla Mutual Fund. Please go ahead.

Achala Kanitkar: Sir my question was with respect to the product mix like you mentioned earlier?

Gopal Mahadevan: Can you be a little louder?

Achala Kanitkar: My question was more with respect to the product mix. If you see in last one, one and a half years we have seen the tonnage moving up, which is where we have seen average realizations going up. With these new norms coming up especially with the overloading do you think the demand will probably shift will be lower tonnage vehicles?

Gopal Mahadevan: I am sorry miss but I am not able to hear what you are saying; the shift will be to lower tonnage vehicles?

Achala Kanitkar: Yes, because now their carrying capacity has gone up by 20%, 25% so rather than buying a 30% in tonner I would probably buy a 31 tonner do you see that kind of a shift in demand happening. So, your volume growth may not get impacted but on the tonnage wise it can come off.

Gopal Mahadevan: I do not think so because you see India is an overloading country at the moment, so what the government is saying is after examining 10000 trucks, they find there is an overloading norm, which has to be regularized, which is what they have done. So, a guy who has been transporting with an overload will, only want to buy a truck, which is going to transport that size of load. He is not going to say, "No let me buy a lower tonnage truck." You understand, if somebody had a vehicle that was could carry 100 and he was doing 120, what that norms are going to do is they are going to regularize 120. So, he is not going to say, "No, let me go and buy 100," because the new norm is 120. I do not think so. It is like formalizing an informal arrangement, which is already there.

Achala Kanitkar: Thanks. I just have this one question. Thank you, Sir.

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

Kapil Singh: I just wanted to know has there been any discussion with the manufacturers that their trucks are capable of carrying 20%, 25% higher loads because the interview from the minister seem to mention that?

Gopal Mahadevan: No, I am sorry can you repeat your question again?

Kapil Singh: Has there been any discussion between the government and the manufactures that he existing trucks are capable of carrying 20% to 25% higher loads?

Gopal Mahadevan: No. There has been no discussion. This is the news that has come up only yesterday. We will have to see it with the formal announcement. In fact, that the entire rollout and that is why I mentioned at the beginning, if this rollout had been consultatively done with the industry, we could have had a glide path to it and ensure a smooth transition, which unfortunately did not happen.

Kapil Singh: But ultimately this is going to depend on implementation because how practically anybody can identify that this is a truck manufactured after July 6, or before that.

Gopal Mahadevan: I agree with you.

Kapil Singh: Thank you Sir.

Moderator: Thank you. We will take the next question from the line of Aditya Ahluwalia from Invesco, Hong Kong. Please go ahead.

Aditya Ahluwalia: Thanks. Just regarding the price hikes relating the commodity costs, are we through with those, or are we still need to take some more hikes to pass on some of the cost increase?

Gopal Mahadevan: See if the commodity prices increase then I think we will have to take hikes, because there is no other choice. We will have to look at how steel prices move. See there are some indication that we are getting from experts in the market that steel prices will come off a bit in the second half of the year that is good news for the industry.

Aditya Ahluwalia: So, whatever has happened has already been passed on?

Gopal Mahadevan: Yes predominately. What I am saying is, these are not actually straight equations, where I say that my commodity is x, so I will pass on x percent. What we try to do is to see whether my net price realizations are improving month-on-month and then I see what is my net cost impact for truck and see how the margins are getting impacted. The moment the margins are getting impacted we start to raise prices.

Aditya Ahluwalia: On that, if you see some flattening of demand because of this regulation or whatever reason, do you see competitive intensity going up further or do you see pressure on margins because of the excess inventory, your reading on that?

Gopal Mahadevan: See, I think competitive strategy will continue to be competitive strategy irrespective of what we are and if somebody believes in pushing stock into the system or the heavy discounting, I think they will continue to do that. If somebody believe that they have to improve network and engage with the customer better and grow profitably, they will continue to do that. I do not think the new axle norms will change that. In fact, the other theory that is going around, there are so many people now guessing if suppose the new norms are also applicable to old vehicles then we are not even going to see a reduction in demand. The vehicles will be bought even today. If there is clarity and if they said no it is for existing vehicles also then existing vehicles will be sold as such. See there are so many theories, but as I said, we have to really wait and watch because one thing that I am sure about is that the fear that all of us seem to be having about this is possibly not to the scale that it needs to be. That is my assessment.

Aditya Ahluwalia: You mentioned that in the implementation of the overloading is as most, when things will probably be even better for the industry than they are right now. What do you think was stopping the implementation as of now? If it was lack of infrastructure, I think that will continue to remain, certain roads did not have these automatic main systems now that still continues?

Gopal Mahadevan: I, frankly do not know, I can make guesses, but I would not want to make a guess. I think the government has chosen this is the most opportune moment to announce and they have announced it.

Aditya Ahluwalia: No. My point is that overloading beyond a point if the implementation of stricter enforcement, is not as easy as what people are making it sound too big, as you know we will increase it and now take this stricter enforce measure. How easy is the stricter enforcement is the question?

Gopal Mahadevan: It is not difficult, either. You see if there are weigh bridges which the entire industry is participating. I mean, the entire industry is not participating, the entire industry is going through if instructions are given, that they have to be implemented, they will be implemented. But I mean, it is about how intensely the limitation needs to be. It is not about how impractical it is. If they need to implement it and they say that they are going to fine heavily, then people will follow.

Aditya Ahluwalia: And just one little thing. The LCV structure which are not a part of the standalone will become a part of the standalone from the next quarter onwards, right?

Gopal Mahadevan: LCV sorry can you repeat your question?

Aditya Ahluwalia: LCV subsidiary ALVL and some subsidiaries which were not a part of this?

Gopal Mahadevan: Yes, the three subsidiary LCV companies yes.

Aditya Ahluwalia: They will come from next quarter onwards?

Gopal Mahadevan: No. The merger has to go through a process. We will complete it possibly by the third or fourth quarter.

Aditya Ahluwalia: So, this year it is will pass on to this Sir?

Gopal Mahadevan: No. This year merger would happen. We will hopefully with the new statuary approvals have the merged accounts.

Aditya Ahluwalia: Thank you. Thanks a lot.

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

Pramod Amthe: Coming back to the axle load situation, assuming that this axle load is for new vehicles do you think the winning strategy is how fast you introduce to maximize this axle load policy or you feel it is a one more variant available to the transporter to clear on it?

Gopal Mahadevan: No. It is not one more, because if they have defined the axle load then all the vehicles that we produce in the next few months, will all have to subscribe to the new axle load requirements. It cannot be that they can buy vehicles, which are non-conformant, and we will also have vehicles, which are conformant.

Pramod Amthe: No, I mean to say your existing models will continue to have those models where the entire loading is not fully exploited?

Gopal Mahadevan: No, it is not that way, you see that is why I said all of these vehicles will have to now get the ARAI approval.

Pramod Amthe: Right provided you want to go to the fullest extent of the load?

Gopal Mahadevan: Yes, we have to. It is not about we are going. We have to. If somebody is buying a 20 tonner for example or a 27 tonner and then they say the 27 tonner can now go for 10% more, which means it will come to 30 tonner, the existing vehicle will have an ARAI approval for only 27 tonnes so that has to be approved for 30 tonnes, otherwise you cannot carry 30 tonnes.

Pramod Amthe: So, the strategy has to be that how fast you come out with those new models?

Gopal Mahadevan: Yes, absolutely so we will do it as efficiently as anybody else.

Pramod Amthe: And second if the norms apply for the entire fleet on the road, do you think any of your warranty provisions, which you build in, can drastically change?

Gopal Mahadevan: It will, the warranty will be applicable only for the old norms. If we have given warranty as per standard load, I cannot give warranty for higher load.

Pramod Amthe: So, you have to review those?

Gopal Mahadevan: No, but we will continue with that existing norms.

Pramod Amthe: Thanks a lot.

Moderator: Thank you. Ladies and gentlemen that was the last question, I now hand the conference over to the management for their closing comments.

Gopal Mahadevan: I think I would only add one thing. You have seen the performance of the company, and I think we have done better than what the circumstances required and been very happy with the performance of the company. The second thing is, with respect to I think the axle load where there seems to be a lot of concern, I do not think the concerns are, at the moment, required to be, or at least the concern seems to be quite significant without us understanding the impact of this. And as I see it, to conclude, I think the impact on nearly 50% to 60% of the existing volume of the industry will be very, very minimal like what I mentioned the tippers or the ICVs or the bulkers. On the rest of it, we will have to figure out how the government is going to look at it. And even if we have to increase the load, I do not think that this is going to make a major dent into the overall volumes of the industry. In fact, at the moment, I would say that, while it is very, very difficult to forecast, if the government, I mean, if the GDP were to grow and the government were to continue making investments into infrastructure, I think the industry would grow at about 8% to 10%. Most importantly, what we must remember, which I think people possibly need to be convinced about is that the market is already an overload market. So, what we are doing is only formalizing something, which is there. And I am not stating it. This is what the government has stated that they have looked at about 10,000 trucks and looked at the overloading pattern and decided that this is how it is to be formalized, so I do not see a demand for trucks coming off. So, I just wanted to share this, I mean, leave this perspective with you, and I am now handing it over back to Jinesh.

Moderator: Jinesh would you like to add any closing comments?

Jinesh Gandhi: I would like to thank the management for taking time out and thanks all the participants for attending this call. Thank you.

Gopal Mahadevan: Thank you very much.

Moderator: Thank you. Ladies and gentlemen, on behalf of Motilal Oswal Securities that concludes today's conference. Thank you for joining us. You may now disconnect your lines.