"Ashok Leyland Limited Q2 Financial Year 2017 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Ashok Leyland Q2 FY2017 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 this conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Gautam Duggad, Head of Research, Motilal Oswal Securities. Thank you and over to you, sir!

Gautam Duggad: Thanks Raymond. Good morning everyone. I welcome you all on behalf of Motilal Oswal for the quarterly conference call of Ashok Leyland. We have with us Mr. Gopal Mahadevan, President, Finance and CFO and Mr. K.M. Balaji, General Manager of Finance, Ashok Leyland. Congratulations to them for delivering a healthy performance in muted environment. Without further adieu I will hand over the call to the management. Over to you, Sir!

Gopal Mahadevan: A good morning to all of you. Thank you very much for the interest in Ashok Leyland. I will quickly brief about the performance for the quarter, which I am sure, all you must have seen in the results yesterday. I think after several quarters you know the industry has actually seen a degrowth, even last quarter we had 14.5% growth in volumes and what we have seen happen is that over the last two years you know the industry had grown at about 16% and then Leyland had grown at 28%.

In 2015-16, the industry volumes had grown at 30%, Ashok Leyland had grown at 50%, even in Q1 the industry had grown at about 14.5% and then we had Leyland growth at about 18% and then we have this quarter where the growth has actually come off by about 14% and Ashok Leyland's volumes have come down by about 19% marginally higher then what the industry had, but that is a bit of a mix and I will also explain the reason for it because it is important to know why we have had this, but more importantly I would say on the positive side we continue to be the most the profitable medium and heavy commercial manufacture in India.

If you look at the MHCV operations, I believe Ashok Leyland continues to be most profitable. We were satisfied with 11.6% EBITDA that we were able to post for the current quarter and on a YTD basis, we are at 11.5%, so we know that our strategy of moderating the cost looking at operational efficiency and also seeing that we get a favourable mix in the entire portfolio as well as ensuring that we do not do deep discount. The second most important thing that I wanted to share with you is that our exports grew by nearly 34% this quarter.

YOY, in exports we are marginally about 2% lower, but that is more of timing issue because we still have a pretty healthy order book in terms of the balance year that we will have to deliver. The third thing that I would say which was again a good thing was that our aftermarket and spares business actually grew by 34%.

If you remember, when I had spoken to investors in various meetings I have shared the basic long-term strategy which the company is to de volatise from the domestic truck volumes because these keep going up and down and this is a classic example when actually you have seen the domestic truck business volumes come off very sharply and you know that impacts all players in the market and we want to ensure that in the medium term, we should have the exports revenue accounting for at least 25% of the revenues over the next three to five years.

We would want to have spares and after market accounting for about 15%. We want the defence to be somewhere between about 3,000 Crores to 6,000 Crores revenue business. Today, it is about 500 to 600 Crores, but you know strategically we are moving in the direction and we have put some building blocks into place. We have started the export international office in Dubai where one of our senior most leadership team members is actually leading the initiative of branching off into Africa as well as South East Asia.

Having said that, we will come back to the results again which had 11.6% EBITDA. We have recast the numbers for the clarity of all investors and analysts who are on the call that the results have been recast as per Ind-AS, and the necessary clarification is actually posted in the second page of the results as well where we have provided the clarity as to how the bridge has happened between the India GAAP that was posted in last year versus the Ind-AS adjustments that have been done.

The second thing that I also wanted to draw attention to is that, in our results, when you look at it, we have specifically also, as a matter of good disclosure, we have disclosed the exchange gain on swap contracts separately. For the quarter, it was Rs.6.56 Crores, and for the nine months the number was Rs.56.24 crore. And that is a favorable impact, but our EBITDA numbers do not include that, they exclude that, because that is not part of operations. And there could be swings that happen, which are favorable or unfavorable, but we wanted to draw attention to the investors that this is a separate line item by itself.

Having said that, what I will do is I will quickly share the overall numbers with you. So, if you look at the total industry volume for the quarter and I'm going to restrict it to the quarter and then move on very quickly, because then we have time for questions. 66,592 was the total industry volume, which was lower by about 14% over Q2 last year. Ashok Leyland was about 22,138. Our market share for the quarter was about 33.2%. On a six monthly basis, it was 32.1%. But, very clearly, we are no longer the 25% market share company we were. We are supra 30%. And on an YTD basis, we are at about 1% lower. Our export volumes were 3,202 units, up 34%. Overall, if you were to look at it, our LCV as well was 8,100 units. It is up 8% over last year. We have a very steady market share of 15% to 16%, even with all the challenges that we have in terms of the LCV business is going through, which hopefully, everything will get sorted out very shortly.

On revenues (net of excise duty), we had Rs.4622 Crores and we were marginally lower by 7%. If you notice, while the volumes were significantly lower, the revenues were only about 7% lower. This was because of a healthy mix of exports, defense kits, and also the aftermarket revenues growing well, which also helped us to improve our margins. Our operating PBT was

Rs.408 Crores, and the PAT, profit after tax, was Rs.288 Crores. Including exceptional, it was Rs.294 Crores. EBITDA, as stated earlier, was 11.6%.

Happy to state that our debt/equity remains significantly lower, far, far away from the 2.4:1 it was about three years ago. We are at 0.3% and our total debt net of cash is about Rs.1870 Crores. For the quarter, our capex numbers are very much within control. We are hardly about Rs.170 Crores – Rs.160 Crores, Rs.170 Crores, on an YTD basis, not for the quarter, let me correct it. For the YTD basis, our CapEx is about Rs.126 Crores and an investment of about Rs.38 Crores in subsidiaries, all of which aggregates to only about Rs.164 Crores. So, we are pretty much well within our overall forecast.

What I also wanted to share in terms of de-growth is that; I will just take a couple of more minutes, because it's very important. There are two or three other points that I wanted to share with you because this will also answer some of your questions. We had a pretty huge base. The industry had a pretty hefty growth in September last year. That was because of the regulatory changes that were happening in October 1 of last year. And if you look at that was because the regulatory changes that were coming in October last year was speed-limiting devices, ABS, as well as the uniform bus body code. So there was a significant pre-buy that happened last year, which is also one of the reasons why you're seeing that kind of a dip happening.

The second point that I wanted to say is that while there is no clarity yet on the GST rates, but in all probability, it appears that it should be 28%. If it is 28%, we expect the fourth quarter to be very healthy, given that there is a regulatory change again on April 1, where on a pan-India basis, Euro IV would be implemented, which means we expect a pre-buy to happen, something that I've shared in Q1 of this year as well. But suddenly in Q2, we had this uncertainty about GST and whether the rates are going to be at 18%. And, if it is at 18%, there is a significant saving for the end buyer and there was a risk that the pre-buying that was slated in Q4 will not happen and all of that will shift into the next year.

At 28%, the rates are very marginally lower, possibly about 100 bps to 120 bps, so 150 bps. And, we expect the pre-buy to happen in the fourth quarter. Obviously, I mean, for the first half, the numbers were flat. I mean, if you look at on an YTD basis, the industry is flat about 1% lower, so whatever growth has to happen, has to happen in Q3 and Q4. October has been a reasonably good month. Of course, there was a low base effect last year. November promises to be okay, because the feeling I mean, the feed that we get from our dealers is that the secondaries seem to be doing well.

Then the third aspect of it that I wanted to share with you was there was a lot of we had a special call for the Board approved agenda of HFL being merged with Ashok Leyland. The process is very much on track, but we need to get regulatory approvals, as well as approval of shareholders. The only point that I wanted to say is, if you remember, in the last call, on the HFL, I had shared with all of you that the management is taking steps to actually turn around the operations, and of course it will take a maybe a two, three year journey or a little earlier, I don't know. But, at the moment, I would prefer to be a little conservative on that. But why the merger is also strategically important to us, given the options that we had, the tax benefit that we have, the financial implications that we had in terms of the Rs.325Crores of preference capital that was there in the company and how we evaluated deeply before taking this decision, I'm happy to state that, on a sequential basis, I would say that, from a negative EBITDA in Q1, the number which was minus 7%, the EBITDA for Q2 is actually now 2%. We have the results which were published just now. I just had a look. Of course, I will not be discussing about the detailed performance of Hinduja Foundries because it's a separate company. But, I just thought I would share this information, because it's the public domain. So there has been a significant recovery of plus 9% in one quarter and the revenues of the company are, actually on a sequential basis, have come down from Rs.166 Crores to Rs.155 Crores, but that's also because of some adjustments. But overall the effect on the improvement in cost is showing up. And, hopefully, we would actually see a loss for the year, which is significantly lower. The management of the Foundries, the Foundries team believes that the market had actually taken Rs.380 Crores or whatever – Rs.394 Crores, which was a loss in March 31, 2016, and kind of pro-rated it for 12 months from 18 months and extrapolated the numbers to be something like Rs.250 Crores, Rs.270 Crores, I think we are going to be far, far that company is going to be far, far away from what people were getting too worried about. Just wanted to give that update, because it is good to have this update as well. And, we will share those details with you, so that investors get a visibility on what's happening.

So with this thing, I would only say that from now on it looks at the moment, and I don't want to sound optimistic, but it looks like Q4 pre-buy would be quite significant, given the changeover that will happen. Having a Pantnagar facility, again, if the government comes with details about maintaining the rationality of Pantnagar investments or backward area investments that could also be at 28%, can be pretty favorable for the Company. So we see some upsides in this.

And I am going to now turn over the conversation to you folks for your questions.

Moderator: Thank you very much. We will now begin the question and answer session. We have the first question from the line Ashish Nigam from Axis Capital. Please go ahead.

Ashish Nigam: Congrats on a good quarter.

Gopal Mahadevan: Thank you Ashish.

Ashish Nigam: My first question was on volumes, so obviously in our last call you had guided that the industry could grow by 15% to 20% this year. I understand, I would see a lot of things have changed since then, but how are we seeing this year now, given how the first half has been.

Gopal Mahadevan: I am going to answer this question as candidly as I usually do. For the last two years, all you folks were accusing me that I was very, very tempered in my forecast and that when I said 15% and 10% growth wherein the actual growth was at 16% and 30% with AL growing at 28% and 50%, you know people said why are you doing this, so I said okay now it looks like the industry has grown and again in the first quarter it looked like it was 14.5% growth and Q1 is a soft quarter, so we thought frankly at that point in time the visibility was that we would look at a growth of about 15% to 20% on an annual basis, but suddenly things stands at Q2, so I am not going to give a growth percentage at this point in time, I think my traditional form of disclosure seems much better, but what I see happening is you know December was also a good quarter last year, I mean good month last year. So we will have to see for the base effect. I am not worried about actually the beating of last year because we finished the last year with about 302,000 units, so I expect that we should finish this year quite higher, if the pre-buy happens. So, I will tell you what is happening in the company, we are actually looking at various options, we are also looking at whether we need to pre-manufacture some of the vehicles and keep it, especially the chassis because it may be required that we have to pre-manufacture and keep including long gestation fully built vehicles that may be need to be exported, etc. So at the moment, our supply chain team is actually putting their heads together as to how do I manage the Q4, uptake if that comes in? All of that started only after the government announced the four slab rates for GST. Unfortunately, there is still no clarity about the commercial vehicle, but in all probability it looks like it is going to be about 28%.

Ashish Nigam: So, we are gearing up basically for the pre-buy in Q4 for now? And so, just on a related note now, how is we seeing even FY18 going into GST, the scrappage policy, I mean, just basically which stage of the cycle are we in? There is a big doubt on that given how volumes have been. So, how are you seeing the cycle overall?

Gopal Mahadevan: Yes, you see I will put it this way. There are two to three parts of this entire thing, okay. The first one is going to be the basic GDP growth, if there is going to be a GDP growth and if India becomes the investment destination that it is expected to become over the next four or five years and if there is going to be a growth that is going to get built up, then I would say that the commercial vehicle industry will do very well, riding on the back of the growth, will require more transportation. The second thing is of course if you look at the external side of it so that is then I would say the external side effect is there are regulatory changes that are happening, Euro 4 is happening in 2020, Euro 6 is happening. The vehicles are becoming more technologically upgraded, so I am sure that some of the larger fleet operators would want to have the latest generation vehicles, but at the same time, the government is coming out with regulatory changes in terms of this cash-for-clunkers scheme where they want to phase out the old vehicles, which is a very big positive for the industry and also we have the concept of over-dimensional cargo as well as over loading going out. Frankly, that is one of the reasons why we are introducing a very ICV truck called Guru, which is India’s first rated load product for a 12-ton positioned at a price point, which is exciting. The reason is the customer is not going to over pay for a vehicle, which he does not need. You know, I do not need a sledgehammer to put in a nail. So it is important that customers buy the vehicles that they need and as we move forward in the medium term with also the investment in road infrastructure, the road infrastructure improving, I believe that the economics of road transportation will be much better. So there are things, which are actually looking positive, but all of this will be kind of addition to the main thing, which is economic growth. So if economic growth is going to be there, I believe that we should see the commercial vehicle industry growing next year as well. GST would be only one part of it. If you really ask me, I do not think there is going to be a huge implication on GST in terms of the CV, in fact it makes the whole thing streamline. I also do not have any concerns at the moment at least when we have spoken internally that the GST is going to make the whole distribution network seamless due to which what is going to happen is there is going to be 15% release of capacity, I do not believe so. If it becomes efficient, actually we will see more investments coming into the sector.

Ashish Nigam: Oaky that is helpful. So second questions is on LCV, if you can just walk us through what our plans are with that business now that we control it completely and the scope of cost savings in the business and basically when do we see LCVs becoming something like a double digit margin.

Gopal Mahadevan: Let me put it this way, at the moment while I am not able to share this only because we are bound by confidentiality and we respect the confidentiality agreement that is signed with Nissan. The deal is progressing well, but we need to complete within a month or so. Once we do that we will be more than happy to share the plans that we have. I believe that once we take it over, the LCV business can become more profitable.

Ashish Nigam: I will come back in the queue. Thanks a lot and all the best.

Gopal Mahadevan: Thank you.

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

Basudeb Banerjee: Thanks for taking my question and decent set of numbers. Just to continue with earlier question was just trying to understand sir as with pre-buying expected in Q4 and seasonally it also being a very good quarter, but on the other side if one sees the GDP growth as you were rightly saying as anyhow been at the similar levels for the last two years and within that the replacement demand was leading to this super normal growth in the cycle, but no signs of industrial recovery or any delta in GDP growth, so how to look at the industry demand beyond this pre-buying assuming the GDP growth rate remains the same.

Gopal Mahadevan: See, let us put it this way, there are two factors there is a past and the future is slightly different because in the past we had a very severe degrowth of 50% volumes getting evaporated up to the year 2013, 2014 after that we saw the recovery happening because there was pent-up demand and then a new government had come in, there was an expectation of the growth in various sectors and there has also been a change in the discipline, you know in terms of the larger fleet operators want to have efficient trucks to manage. So we did see this huge growth that happened in the CV sector and that is why the industry now we will see the TIV is also almost at 315000, 320000 this was before the crash, the TIV was about 350,000 so if we were to look at it in those terms, I think the growth has happened satisfactorily. From here on, we are sitting on a slightly larger base and at that base level and the economic recovery happen, I think the growth will be there, but it will be marginal, but if there is a deceleration of the economy one cannot expect any growth. So for me to stay that 17, 18 is going to grow, it is going to hinge a lot on what we see as, you know there are also elections happening, but if the government initiatives continue and I say I mean even I know I did not have time to discuss about the other two of course completely not related thing, which is actually sitting on our mind, the US presidential election and huge stock market crash that is happening and also the tracing out of 500 and 1000 rupee notes, which will have an impact on a number other sectors, real estate seems to be most affected on that, etc. But having said that I think the government is taking some bold steps irrespective of you know the impending electoral event that will happen after maybe in about two years' time. So the government keeps doing all that you know what it needs to be doing on investing into investment led growth. I am pretty positive about it. See I cannot talk in year terms because a lot of buying will happen on events, you know tenders have to be issued, you know power plants may have to be revived or whatever I do not know. Infrastructure projects have to be revived, ordering has to happen, so today if you look at it steel, cement, etc., are very flattish, you know steel is actually on a protected industry so they are able to prove the profits that is there based on this protection. Now will this continue or will they open it up. If that opens up, the whole cycle can get completely changed or if they find that the existing profitability of the industries grow up and they want to make some further investment anticipating growth then you see a complete different picture. All I can tell you in the medium term and I am doing my long-term plan, I am looking at the commercial vehicle industry growing at about 12% to 15% annually that is how I am planning. I do not see any reason why I should not plan that way, because planning is also about being assured, not only being very conservative, but at the same time also looking at opportunities for growth because ultimately we have to grow, so for us that is why we said we are looking at growing outside India, we want to grow the defence business. I have 11 tenders. Which have to be executed, which have been ordered, then after that my spares business is growing. The truck business of course is I would say the heavy weight in the whole system and it drives the overall performance of the company, but I expect that next year should be a growth year provided nothing untoward happens, will it be 20% to 30%, I will have to wait and watch, but I would say a 10% growth should happen next year also.

Basudeb Banerjee: So broadly in a nutshell, if the macroeconomy and the demand driving sectors for trucks remain status quo, a single digit growth in FY2018 is possible.

Gopal Mahadevan: Even a double digit is possible.

Basudeb Banerjee: Second thing sir, if I see your gross margin as the improvement for the second quarter in a row, so any specific reason it is sheerly because of some spares and defense mix improvement or if you can highlight that.

Gopal Mahadevan: I will say that it is a confluence of the defense, it's a confluence of spares, it is a confluence of material cost reduction that we are doing, net of the material price increase that has happened, and exports. Some of the export business has healthy margins. So we would want to keep it that way, because that's how the strategic initiative of the Company will pay off. So, that is the reason why we have been able to do it. We are continuing to be tight on costs, and we are continuing to keep improving the mix in the overall portfolio.

Basudeb Banerjee: And sir what was the quantum of defence and spares revenue this quarter.

Gopal Mahadevan: Well while we do not give out the details, all I can tell you very broadly, I would say that in terms of exports, exports was 700 Crores per quarter.

Basudeb Banerjee: 700?

Gopal Mahadevan: Yes, so that was a very important phase we have had, defence revenues about 200 Crores and if you look at aftermarket revenues were around about 250 Crores.

Basudeb Banerjee: So almost 1100 odd Crores so almost 22% of you revenue coming from non-CV revenue per se.

Gopal Mahadevan: See directionally we want to take to this, I am not going to say this is where it is, next year will be another, next quarter.

Basudeb Banerjee: Sure, sure, sure, some volatility definitely happens Sir for your supply to defence, etc.

Gopal Mahadevan: You know, if you draw that curve, there will be ups and downs, up and downs, but directionally the line will be moving upwards, you know, so that is what we are getting at and we are confident about. We have a new team in spares and they are doing a wonderful job. I do not have the time to share this but the way we are looking at aftermarket the relationships are different, we are saying that Ashok Leyland brand has to come into the parts, so that when somebody opens the hood it is not X manufacturer or Y manufacturer, but Ashok Leyland, which is there, you know in a break shoe or in a you know in the filter or other parts.

Basudeb Banerjee: Sir any major change in the blended discount for the portfolio this quarter?

Gopal Mahadevan: Yes, I wanted to share that. Thank you for asking the question, because I felt a little guilty about my very long monologue at the beginning. But the discounts continue to be disturbingly high and we have stayed away, and that's one of the reasons why our volumes are a little low. We have stayed away from; let me tell you, unprofitable STU businesses. If I wanted to quote it, I could have improved my volumes and we could have probably stated that my volumes are high even though the industry volume has fallen, we have grown. No, we don't want to do that. We are becoming for us, like I told you, there are three important things. One is market share. Second one is EBITDA margin and the third one is operating working capital, and for us, ROCE also is important. So for us, we want to pick up business, which will be profitable, and the discounting level, believe me, a 37-tonner has been offered at the price of a 31-tonner. We don't do that kind of a business. We are very clear about it. And if you notice, we don't want to take competition strategy here. But, we have seen some competitors that you can analyze it, where they have actually grown in volume, but their EBITDA margins have come off. Revenues have gone up, but EBITDA margin has come off. So that is surprising. That actually reveals the strategy that is behind the pricing. So, for us, we do not want to buy market share. Now, are we puritan about it? I don't think so. Is it 100% the way to do? No, we cannot do that. If we have a very significant customer, and he says, hey, this is what competition is offering and this is what you guys are offering, we have to work on the relationship. But on a blended basis, I don't want to keep discounting and discounting and report market share growth, because it is meaningless. So, we are really fighting, because you should know about it. How the Company today works? Three years ago, three-and-a-half years ago, there was one P&L in the Company. After that it became six businesses, six P&Ls. After that, there were five zones, so six into five, 30 P&Ls. Today, we have 253 P&Ls, which means it's not only a zone, a regional manager is also having a P&L. Balaji here, sitting with me, actually prepares all that. Now, once that is done, a regional manager gets a P & L for each of the sub-vertical in his region. Now, on one side truck vertical has been divided into sub verticals like haulage, mining & construction and distribution, so similarly for buses. On the other side viz., covering geography, we have moved down from Zones to Regions. So what we are doing is, we are trying to get focus on a business, as well as the geography, and each of these people are being given targets, which is on market share, operating working capital and EBITDA margin. So sometimes what happens is if you have to maintain the EBITDA margins, you will have to let go off certain businesses. We are happy to do that if it does not make financial sense. Discounts have gone up significantly; let me tell you this quarter. Why they are going up? I'm not too sure. But this is not a sales technique. Anybody can sell anything at a discount.

Basudeb Banerjee: Yes sir, but as you rightly said the main competitor, who has been taken this discount ploy, but the market share of that player is pretty much like maybe single digit also in the HDV segment, so even that player is able to make such a large impact for the bigger players.

Gopal Mahadevan: Yes, see the problem is like this. You see, if somebody comes in, even if he is not as large and they start discounting, that becomes a reference point. See let me put it this way. I do not want to talk only about discount, look at it even in products. We possibly are the only Company, which has been actually introducing very marquee products. 3718 was an introduction by us, market followed? What did they do? Have 3718 and discount on it. You see we do not want to follow that path. We have not actually developed any product as far as I know. We like a marquee product. Some adjustments may happen if somebody is offering some feature, which is not there. It is a good-to-have thing we will do that. But you cannot talk about Ashok Leyland having aped any other product and actually introducing in the market. So we continuously or you take Jan Bus for that matter. It is a product introduction that has been done by the Company. So what happens is we are looking at actually filling gaps. So our strategy is, of course, I have to match the pricing. I'm not saying I will not, but not at a deal level. I will see whether some of my key customers, do I have a chance of losing them because of this. Then, I actually go and say I am going to go and say, now this guy has offered an Rs.4 lakh discount actually and he is making a negative margin, so I will offer you the Rs.4 lakhs, no, I do not do that. I do not sell at negative margin, first. It is very clear, okay, because there is no point in selling at negative margin. I cannot produce a product and then say I will sell at negative margin. Now the point is the thing is we will say, okay, is this is your total cost of ownership? Okay, now let me tell you that we can get this better in total cost of ownership, which means your initial procurement, plus the AMC, plus the maintenance and fuel cost and whatever, tyre wear, etc, etc. So, we are actually trying to approach this whole problem holistically. We are investing let me tell you, not in capex, significantly, but in a lot of initiatives, including reaching the customer for spares, ensuring that services are significantly better than competition. Let me tell you, our market share improvement from a 25% player to a 32% player has not been by price. It has never been on price. It has only been on network. It has only been on products and now it is on service. I just thought I would give this perspective to all the people who are logged on to the call.

Basudeb Banerjee: Sure Sir. Thanks and that is it Sir.

Moderator: Thank you. The next question is from the line of Pramod Kumar from Goldman Sachs. Please go ahead.

Pramod Kumar: Thanks a lot and congratulations Gopal and Balaji for an excellent set of numbers.

Gopal Mahadevan: Thank you Pramod.

Pramod Kumar: Gopal, my first question pertains to the non-truck business, because you mentioned 22% was a non-CV business. I just wanted to get some color as to how much is the non-domestic truck business, basically excluding domestic trucks, which are the most cyclical business, how much of your revenues currently in this quarter is from?

Gopal Mahadevan: Domestic truck business accounts for about 50% to 55% in the entire portfolio.

Pramod Kumar: And it used to be a higher number earlier?

Gopal Mahadevan: It used to be higher. For example see, that is why it is very difficult, because I do not want to you guys to conclude, but you know it could be 60% also. Last year same quarter was about 64%. But, what I can only share with you is direction. So even I do not know beyond a point. In a sense, if you ask me what it is going to be next month, I can tell you. Now, next quarter exactly how much is it going to be, I would not know, because my export shipments have to go, and then after that my spares sales has to happen? My defence some of these things the government or the STUs, or everybody also needs to pick up. It is not just about me making them. Sometimes even the pickup/delivery does not happen. They will say I will take it next month. But broadly what we want to do is to get this 55%, 60% business, down to about 40%. Believe me, that is a Big Goal. It is not easy. But, we are actually putting in place things. Like, for example, let me tell you, three and a half years ago if I had told someone, when we started this whole journey, if I had said, no, the debt/equity of Ashok Leyland will be 0.3:1, everybody would have laughed, because it was so unbelievable at that point in time. Now, I am not sitting on arrogance at all. The entire management team, I am telling you, the philosophy of the management is, yes, we have done all that, but that's all in the past, okay. Now we have to look at how do I get my further weight reduction plan in, okay? From 95 to 85 is great. Yes, we have reduced. Now, from 85 to 80, and 80 to 75, how long am I going to get it? Because it is going to be even more challenging, but we have got our people in place, we are putting our resources in place, we are also looking at how we release management time, and how do we not put in efforts, which are not customer-focused. All of us, I will tell you, including me and Balaji sitting here and everybody in finance, HR, everybody is now customer focused. Everything is now getting into customer focus. Am I doing things, which are on the customer? If they are not, why am I doing it? Is it necessary or can it be eliminated, or can it be outsourced? That is a project that is currently going on, because we cannot keep adding more and more people, because I am generating more revenues. But, the philosophy is, for performing the job of five people, hire three people, and maybe possibly pay for four, and keep them motivated. So, the whole thing is actually getting into productivity. But, at the same time, we have also put in we are laying our building blocks. Dr. Seshu Bhagavathula who has come in from with a vast experience and who has also had a stint in Mercedes-Benz, has actually come in, because he is putting the blocks together for Modular Business Program. So, while the quarter is very important and we need to perform every quarter and we are trying to do that, we are also putting in places the larger things that we need to get going.

Pramod Kumar: Thanks, thanks Gopal. My second question pertains to the overnight development in India, in terms of what do you sense could be the first reaction to all this, in terms of the liquidities at the working capital cycle at the trade level, because as you would appreciate, the fleet industry is fairly works on regular a daily cash rotation or daily freight receipts or whatever. So, anyway what is your sense in terms of what how could be the next two, three months in terms of volatility for demand, and which could probably have implication even on the pre-buying, because of there is liquidity which gets dried up because of all this, how would you read this? How would you look at the demand in the short term? Forgive me, it is a short-term question, but honestly, we are trying to understand as to what could be the near-term implication for the sector.

Gopal Mahadevan: **This is not** short-term at all. In fact we are also kind of looking at the impact and we are working this out, because one of the things that will happen is the fleet operators who run on cash, because they have to pay money in cash for either even if a tyre were to fail, you have to pay in cash, or if you have to do a sudden oil change, you have to pay in cash. So we are working towards that. I think all industries, including FMCG, or cigarettes, or I would say, commercial vehicles, all of them are actually going to have some challenge in terms of converting this whole thing into this new system. So, it is on short-term, if you really ask me, it is not a positive for anyone, okay. Now what is short-term? I think that the recovery of the system will happen over the next 15 to 20 days, because I was a little shocked by the WhatsApp messages that were coming. WhatsApp message, it was saying that the new notes would come only in February. Then I said, man that is going to be very difficult. But, I am given to understand and I do not know, I am also in hearsay, because I have been in calls and I have just walked into a call, I am also hearing that the new notes are going to be effective in two days' time. If it is two days' time, the impact is significantly lower, because if there is unaccounted money which is in circulation, well, that is going to impact all of us for at least about a month to two. But, will it go into the fourth quarter? The chances are very slim, because the system would have automatically adjusted itself. I would say that November and December are going to be tight. See, a lot of things are going to change. I mean, including the local paan wallah to the local shops and including, I will tell you, my driver called up late last night and said, Sir, what do I do, I have got a mother who has to have some treatment or whatever and I have got this money. I said do not worry at all, I mean they are going to take it. So, there is a lot of uncertainty in the market today, which is impacting, and I think it is going to impact the people who do not have a credit card, which means it will impact a whole horde of industries, including us. Will it be long-term? I do not think so. Will it be even in the fourth quarter? At the moment, I do not think so. In fact, if there is any kind of a shiver in the current two months, the reset actually will happen in the fourth quarter.

Pramod Kumar: So in a way, you do not see any impact to the folio projections or to the longer-term projections for the industry.

Gopal Mahadevan: Hopefully not, unless the end industry decides to produce less. For example, if you believe any particularly sector is going to produce less then I have a problem. One area where I can see some negative is on the real estate side because you know that sector you know may get impacted. When that gets impacted, goods and services transportation for the real estate could get affected. Right but then if that gets affected, steel and cement will get affected, but I do not want to be you know a negative player because I really do not know what the impact is. It is a little too early to state because the whole thing can may be right itself in 10 days' time also.

Pramod Kumar: Fair enough, Gopal. I think given the uncertainty that is also helpful. Thanks a lot and best of luck for the future, thank you.

Gopal Mahadevan: Thank you.

Moderator: Thank you. Before we take the next question, we would like to inform participants that due to time constraints, we would be able to take questions from three more participants.

Gopal Mahadevan: I am sorry because I have board meeting, again I have to attend at about 12:30 so you know I am not able to stretch this conference call beyond this, but please go head.

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

Chirag Shah: Thanks for the opportunity and congrats Gopal for good set of numbers.

Gopal Mahadevan: Thank you Chirag.

Chirag Shah: Yes, Gopal, one question I had on this commodity cost pressures, if you can shed some light, because recently the raw materials for the steel industry costs have gone up, the met coke, pet coke prices have shot up like anything. So, when and how big the impact can be for a trucking company and when can the impact be seen?

Gopal Mahadevan: Yes.

Chirag Shah: So when and how big the impact can be for trucking company and when can the impact is seen.

Gopal Mahadevan: See, at the moment you are right. We are also actually grappling with that, in the sense that we are reviewing the situation as to what can be the impact that will come as we go forward, because there is still the special duty also, which is on top of it. So, probably the government will see some kind of a sense in the overall thing, because we are having an unnatural increase in steel prices within India. The second part is, yes, we are expecting that if the steel prices go up, there will be a natural tendency to pass it on to the customer. And while there has been a de-growth quarter, in the fourth quarter, when there is going to be a demand-pull, we believe that the price increase reset will happen.

But, overall, can there be an impact on margin because of steel price increase? I believe some marginal impact should be there, provided we are able to pass it on. If the sluggishness continues into Q3 and Q4, then we have a challenge in passing it on, because there is no price elasticity. At the moment, I think that price elasticity would come in, in the fourth quarter, possibly even in the current quarter, let us see. Then we should be able to pass on the price increases, because as of now, we have not taken a huge hit on the material price increases till now.

Chirag Shah: Generally even for some of the competitors we have given the numbers, the numbers are not as bad as the risk of discounting has been highlighted, so we keep on hearing the discounts are very high, but in general the margins of industry seems to very reasonably healthy.

Gopal Mahadevan: Yes, the margins of the industry are reasonably healthy. The point is, the level of discounting that is happening, and I cannot discuss certain things in an open call, but when you read the last 10, 15 days' newspapers, you will come to your own conclusions how discounts are being done. But, the basic point that comes up is, it is all you see, pricing still continues to be a strategy for customer acquisition. Company, we are trying to move away from that. Not that we are saying that it is infra deal or anything. Yes, price is very important, right. So, it is not that pricing but pricing cannot be the only strategy. Now if you really ask me, while everybody says that discounting is not happening, I had seen not one, not two, but many cases, in certain regions where for a Rs.22 lakh vehicle, there is a Rs.4 lakh discount.

Chirag Shah: But, that's why I referred to average discount across fleet. Is it right that around Rs.225000 to Rs.250000 number.

Gopal Mahadevan: Yes, that continues. For me, my market share this quarter, I also wanted to share that, and I would request everyone to kind of just listen to what I am saying is the market share, first of all, is a confluence of two, three things. One is the absolute volume. Two is the composition of the volume. So, if you look at it, between my Southern volumes versus non-Southern volume there is a difference, because my market share in South is about 51%, right. So when that now what has happened if you look at if you cut the TIV, degrowth has happened the highest in South zone. And then what happens is, I have to not only maintained my market share, but the discounting has also been very high in the South, because this is my backyard. Now I am not saying I am not complaining I am just giving a perspective. Now we have been able to grow our market share on East and North. For us, east, about five, six, maybe, six and a half years ago, the market share was 7% or 8%. Today I am at about 23.5%. Still not steady state, but I am over 20% month on month. So we are growing, right. North also has been about I do not know 24%, 25%, Balaji?

K.M. Balaji: Yes.

Gopal Mahadevan: So on a PAN India basis, we are now at nearly about 25% to 28% so we are actually ensuring that a PAN India presence is stable and we have two strategies, we have challenged the leadership strategy and defend the leadership strategy so for example in South I have to follow the defend the leadership strategy. In the rest of the area, I have to look at challenging the leadership, if I am not the leader and then you have to cut it down not only into market share, I will have to cut it down into product segments. Now for example this quarter the second cut that I wanted to say, which I missed telling is the tipper and ICV business has grown, right. For us, we have also gained market share in tipper and ICV business, which is good for us, but is a traditional business, there has been certain amount of discounting that has happened, so when you look at the average we have stayed away from, even if you look at bus my market share has come off because I stayed away from the STU business, which was remunerative. I stayed away from private business where the discounting was extremely high, but overall if you ask me, yes, the discounting is about 2.25 to 2.5, but what is the proof of the pudding. The proof of the pudding is I am able to post 11.6% EBITDA.

Chirag Shah: Yes, that is why I was highlighting that everybody is highlighting discounting very high, but profitability seems to be really so the industry has done some reasonably strong credible job.

Gopal Mahadevan: Thank you.

Moderator: Thank you. The next question is from the line of Binay Singh from Morgan Stanley. Please go head.

Binay Singh: Thanks for the opportunity, sir just continuing with the earlier question, fair to assume that discounting was pretty high throughout last quarter right?

Gopal Mahadevan: Discounting, yes.

Binay Singh: Secondly sir, other expenses, we have seen them jumping on a YOY basis, could you throw some light on what is happening over there?

Gopal Mahadevan: The main reason the other expenses this is an accounting issue and the main reason the other expenses have gone up is because of the expenditure that are related to our exports. So that cannot come in material cost. For example, in some of the exports orders, we have to give ticketing systems we are also giving special services for installation of spares depot and jobs like that. That is part of the project. What we do is, when we are internally looking at it, I look at whether my gross margin, net of all this indirect expenditure, which is part of the contract, does it give me the results that I want, and it does. So when you see that there is a significant quantum of expenditure, which is actually related directly to sales, which is the reason why the other expenses have gone up. Marginally, let me tell you, my travel and communication, my travel has gone up, nothing to be worried about. We are doing this on a need base, because we have to invest in meeting people in new geographies, etc., etc., But these are the two major reasons. I mean travel is also very insignificant in the overall size. The main reason is spends relating to export.

Binay Singh: Right, that is very clear. Sir secondly what percentage of your raw materials will be pure metal buying, like steel?

Gopal Mahadevan: It would be direct, steel buying would about 35% I guess.

Binay Singh: 35% of raw material sales.

Gopal Mahadevan: Yes.

Binay Singh: Sir lastly what is net debt for the quarter and quarter ended?

Gopal Mahadevan: Can you give the net debt number Balaji.

K.M. Balaji: Yes, 1870 Crores.

Binay Singh: Great, that is it from my side. Thank you so much.

Gopal Mahadevan: Thank you.

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

Hitesh Goel: Thanks Gopal for taking my question. I have two questions. First is, can you please explain why gross margins on a Q-on-Q basis has gone down? I mean it is improved actually, because if I look at mix or I look at defence as a percentage of sales, it has not improved much, on a Q-on-Q basis. Mix is, I mean, neutral to slightly negative. So just want to understand what has happened in this quarter?

Gopal Mahadevan: Q on Q of last year.

Hitesh Goel: No, 1Q FY17 versus 2Q FY17, which is comparable on Ind-AS, actually raw material to sales has come down by 100 basis point, so just wanted to get a sense on that.

Gopal Mahadevan: Raw material the sales has come down because of the following reasons, one is very clearly the mix because when we have my export constituency going up you know so what has happened I have had a 34% jump in exports, so that is why I said between Q1 and Q2 one of the key driver has been exports and it has been pretty profitable and I think in terms of even you know the aftermarket revenues have gone up. So aftermarket is high margin business, it is about 35%. So for me these two reasons have actually resulted in a better raw material cost.

Hitesh Goel: Have you taken any price increase in this quarter?

Gopal Mahadevan: Thank you very much for asking we did that possibly we are the only people who have increased prices on 1st of November.

Hitesh Goel: Okay how much if you can tell me the price increase

Gopal Mahadevan: About a percent.

Hitesh Goel: 1% you have increased and that it has come through to the top line, right.

Gopal Mahadevan: No, this is not this quarter. I am talking about in November. In, I think, Q2 we have not taken any price increase. Have we, Balaji?

K.M. Balaji: No, no we have not taken any price increase in Q2.

Gopal Mahadevan: But in the third quarter in November, we did take a price increase.

Hitesh Goel: Okay and my last question is on sir this you know we had done some discussion with fleet operators also and like you said you know that you do not see a major impact of GST implementation on truck sales, but do you think they are thinking how the fleet utilization may get impacted when GST comes sir. So that uncertainty will prevail in their mind. So do you think that these concerns are being highlighted by fleet guys to you because pre-buy will also be dependent on that, it is not only rates in my view.

Gopal Mahadevan: See I will tell you, the pre-buy is going to be dependent on very rightly, so the perception that fleet utilization will have, but I think that there are two to three things. The guys who want to buy, if they see a business potential are going to buy. Nobody is going to buy a truck if he does not see a potential for it to be used. You know this is not like investment in capacity that we do there with you over four to five years. You build a cement plant or a steel plant stating that you know I need to start using it over five years, six years, seven years or eight years. This is more like you know I have to use it in the next quarter, next two to three months, so then they will buy it only there.

Hitesh Goel: Sir what is your revised guidance for the industry for this year now, FY2017, I just missed that if you have given that earlier.

Gopal Mahadevan: The guidance and for the industry, I would want to wait and watch, because there are so many uncertainties. It is very difficult for me to what I can tell you; again, I will just repeat it in one sentence. Our team today, as I am talking to you, and let me tell you, this happened last Sunday, okay, of all days. Our team, our supply chain team was working together to see how do I plan my manufacturing for Q4 and what is the kind of inventory levels I have to plan at the end of Q3, I am being very open. In the business of manufacturing and selling trucks and buses, certain amount of strategy is involved. So I would want to be as open with you guys as possible. So the expectation internally is that we have to be ready for a good pre-buy in Q4. We believe the pre-buy is going to be good. Nobody expected now of course now my dear friend Pramod Kumar asked me, I mean what is the impact on this? We are still kind of looking at various implications for what has happened yesterday, which is good. I mean, in the overall economics, it is a great step. But in the short term, is there going to be an impact? It could be there, we do not know. So see the whole uncertainty of things which is actually happening is we are not able to make a prediction. If it were a very normal year, I would have said Q4 is a fantastically pre-buy.

Hitesh Goel: Only one last question that is very important. I just wanted to understand, see basically April 1 emission norms will change, right. So you will have to plan inventory quite carefully in the fourth quarter, because I am not sure whether you can sell the dealer inventory after April 1 for Euro III, I mean Bharat Stage III. My understanding right or you are in discussion with the government to give you some leeway on that?

Gopal Mahadevan: I had a discussion with the government because earlier the thing was it was the date of production and not date of sale. Then I have no problem in inventory.

Hitesh Goel: Yes. So but right now I think there are some discussions that government may not allow you to sell. So there is some discussion going on regarding this so that is why I want to clarify.

Gopal Mahadevan: That is going to be very, very difficult for the industry to manage, not only for us, but for everyone, including pass cars, but of course pass cars, most of them are in Euro IV, so there is no problem. But if there are Euro III cases, it will have the same problem. So the point that comes up is that we expect that the government will allow the production date to be the day, which means, if I produce a vehicle after April 1, it has to be Euro IV. If I produce it before, it can be Euro III and then it can be sold as well, because it's on a chassis controlled number. So hopefully that's what will happen. At the moment, it's another imponderable. So believe me, the number of moving parts in running this is business is pretty high. That's something that I've learned. But let's hope that we are able to sort that issue out. We'll sort it. I mean, all this ultimately requires a little bit of logic and astute planning. We will do that.

Hitesh Goel: Thank you very much and all the best.

Gopal Mahadevan: Thank you.

Moderator: Thank you very much. That was the last question ladies and gentlemen. I would now like to hand the conference back to Mr. Gautam Duggad for closing comments.

Gautam Duggad: Thanks to the management for taking time out for this call and all the participants who were participating actively in the call. On behalf of Motilal Oswal, I thank you all. Have a great day.

Gopal Mahadevan: Thank you very much everyone for the interest in Ashok Leyland and thank you very much Motilal Oswal as well.

Moderator: Thank you for joining us ladies and gentlemen. You may now disconnect your lines.