



“Ashok Leyland Q2 FY 2016  
Earnings Conference Call”

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**Moderator:** Ladies and gentlemen good day and welcome to the Ashok Leyland Limited Q2 FY'16 Earnings Conference Call hosted by Batlivala & Karani Securities India Private Limited. 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 for 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. Annamalai Jayaraj from Batlivala & Karani Securities. Thank you and over to you!

**Annamalai Jayaraj:** Good morning everyone. On behalf of B&K Securities welcome to the Q2 FY'16 post results conference call of Ashok Leyland Limited. I also take this opportunity to welcome the management team of Ashok Leyland Limited. We have with us today Mr. Gopal Mahadevan, CFO and Mr. K. M. Balaji, General Manager, Finance. I would now invite Mr. Gopal Mahadevan for his opening remarks to be followed by question and answer session. Over to you Sir!

**Gopal Mahadevan:** Thank you Jayaraj. Thank you ladies and gentlemen, thank you very much for the interest in Ashok Leyland and I am happy to present the Q2 FY'16 results for the company. The total industry volume at 77249 units in Q2 actually has resulted in a growth of the industry by 43%. We have actually seen the trend continue from the previous quarter. On an YTD basis the industry actually has grown at 34%. Ashok Leyland in Q2 has grown at 78% as against the Q2 industry volume of 43% the volume in Q2 was 27502 units as opposed to 15,472 units in Q2 last year. Our exports has been a tad lower this quarter but we believe that we will be definitely catching up in Q3 and Q4, exports have been at 2382 units as opposed to 2735 which is marginally lower than last year but this is more to do with the timing of the exports and deliveries, so overall the M&HCV volume was 29,884 which was up 64% against 18,207 in Q2 last year. LCV volumes were still bucking the trend they were 5% higher 7497 units as against to 7172, the market share still continues to be stable at about 16% and if I move on to the financials I would say that this has been a kind of first of sorts in the last 17 quarters, we have had the highest volume and also the highest EBITDA margin. Our EBITDA margin for the quarter was at 12% revenues at 4940 Crores was 54% higher than Q2 last year, our PBT was 433 Crores at 8.8% of revenues and 5.1% in the same period last year and in absolute terms the growth has been 162%, our PAT was at 287 Crores as opposed to 121 Crores in Q2 last year. Debt equity I am happy to share is 0.7, we have generated 823 Crores of cash and our operating working capital again has been lower even sequentially, it is at about 5 days now, so overall I wanted to give the encapsulated performance and what I thought I would do is I will quickly readout the half-yearly numbers as well and then hand it over to the floor for any questions that you folks may have.

I had already mentioned that total industry volume had grown at 34% and the volume was at 1,39,325, Ashok Leyland volumes was at 46,074 up 63% and our exports were up 9% and at 5263 units and in terms of revenues we are at 8781 Crores which was up 54% our PAT was 446 Crores

which is significantly higher than the 73 Crores that we have recorded in H1 last year, actually it is up 513%.

EBTIDA margins for the first half is 11.2% I have already shared the debt equity ratio, one point that I also wanted to share is in the current quarter is that we have had two exceptional items one was the impairment that we have taken in the interest of good accounting ie., we have taken an impairment of 157 Crores, this pertains to the investment that we hold in the joint venture Ashok Leyland John Deer Private Limited. We have also had an exceptional sale of IndusInd Bank shares which is explained in the results, so overall I think the quarter has been very, very satisfactory in terms of the total performance parameters, in terms of volumes, profitability, we have seen that the benefits of the cost reduction initiatives that we have taken both in material and overheads continue and our efforts in actually reigning in working capital continue to improve our debt situation. So now I am handing over the floor to questions. Thank you.

**Moderator:** Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Binay Singh from Morgan Stanley. Please proceed.

**Binay Singh:** Hello Sir, congratulations for the good set of numbers. My first question is on the topline could you share a little bit with us that what was the breakup because we do notice that ASP slightly went down quarter-on-quarter, so could you share with us what was the break down of revenues in terms of M&HCV, spares and engines?

**Gopal Mahadevan:** Well we actually give a broad breakup of the MHCV and I can give you the bus and truck volumes but other than that we actually give a consolidated number. Balaji would you want just give the MHCV truck and bus volumes for the quarter?

**Binay Singh:** Not volume Sir, revenue mix, if you could share something on the revenue mix.

**Gopal Mahadevan:** I will give you the mix of M&HCV, see the M&HCV roughly t trucks constituted about 64% and the buses constituted about 13% and LCV was about 6.5%. Exports, as I had mentioned earlier was about 8.6% the rest of it was spread over spares and engines and defence.

**Binay Singh:** And this is all in the revenue terms right?

**Gopal Mahadevan:** Yes, all in the revenue terms, in rupee terms.

**Binay Singh:** Secondly if we notice the results we have seen that the gross margins have gone down, could you talk a little bit about is that because of the mix or is most of the commodity benefit yet to come or has that come through?

- Gopal Mahadevan:** No I would say two things. Actually there are three large buckets in which will fit this, one is that there has been commodity benefit that has come in but I would also draw attention that you know the company has been pursuing cost reduction in the field of material. I shared with you some of the initiatives that the company has been putting through so all of that is actually trickling down to the bottom line but you rightly said one of the major things that had happened in this quarter has been the mix. In the previous quarter if you look at it sequentially we have had a larger amount of exports coming in and defence supplies which actually in terms of material cost to sales was lower than the mean but if you look at it on quarter-on-quarter basis our material cost has actually come down quite significantly its more than 3% down.
- Binay Singh:** Right Sir. So basically it's a mix?
- Gopal Mahadevan:** Absolutely we are deriving benefits from our cost reduction initiatives and yes there are benefits of the lower commodity prices also coming in.
- Vinay Singh:** So in that sense you are saying that the full benefit has not yet flown through?
- Gopal Mahadevan:** Yes it has not yet flown through but it will flow through.
- Moderator:** The next question is from the line of Kapil Singh from Nomura. Please proceed.
- Kapil Singh:** Sir, couple of questions. Firstly on the employee cost we have seen a sharp jump from 1Q levels so any thoughts there that any one-off there or some non-recurring items?
- Gopal Mahadevan:** No, I think what happens is you see absolute numbers and then see the growth and then I see percentages and I actually say that this is one of the lowest employee costs that we have had over the past few quarters. So our employee cost as a percentage of sales is about 7.7% and I think it was 8.6% in Q1 in the current year itself. So in absolute terms when you look at it employee costs are higher because there are certain provisions that we have had to make in terms of employee cost increases and that's the only reason.
- Kapil Singh:** Okay. So I mean just some thoughts from you on how we should expect them to come through for the rest of the year?
- Gopal Mahadevan:** Well I think I would say two things, one is actually to evaluate the company quarter-on-quarter may not be the best way of doing it because there are certain lumpy numbers that can come in a particular quarter but overall if you look at it I would view employee cost as a percentage of sale because when my sales is growing at disruptively high rates one can't expect that the cost numbers will be absolute. We must also remember that we have had two very challenging years just one year back where employee cost there have been, the cost were flat in fact they were negative we had shed manpower also which was the appropriate thing to do at that point in time but as the industry is looking up and as

the company is doing well the company should also ensure that its rewards mechanisms are appropriate. So one would actually see in absolute amounts cost going up but I would say that is only one way of looking at the numbers it would be better to look it at the percentage of sale whether the numbers are coming down or not and which we believe it is.

**Kapil Singh:** Okay. Understood because historically your employee cost have been fairly stable kind of number this quarter there was almost a 50 Crore kind of increase so that's why I thought I will check on this. Secondly on your market share we have gained significant market share in the last one or two years, how do you see that evolving over the next one or two years?

**Gopal Mahadevan:** See for us the focus is our customers. The focus is actually not on market share in the sense that we are not saying that we ignore market share as a number but we are actually seeing whether we are able to retain our existing customers, make them more satisfied, are we able to acquire more customers in segment that we are not in or in geography that we are not in or acquire larger shares of business of existing customer itself. Now all of this actually translates into market share. Now so in absolute terms if we were to look at market share as a percentage I think that while we will pursue to retain our shares there could be oscillations that come in up and down but one thing we are very clear which I have been mentioning in the last calls also Ashok Leyland will continue to pursue only meaningful market share which means its not going to discount heavily and acquire market share because we are very clear, market share is just one metric that a company's performance is evaluated on. There are profitability matrices, there are cash flow matrices and there are so many other aspects to a company's performance. So while we would continue to retain as much of market share as possible I think we would also want to see to it that we retain this profitability and we are able to improve the profitability of the company.

**Kapil Singh:** Sir last question on the net debt. From March to now how much capex you have done and how much net debt movement is there because it looks like it's only around 200 Crores kind of reduction?

**K. M. Balaji:** The capex for the first half is around 55 Crores and it includes investment of 13 Crores.

**Gopal Mahadevan:** See we have given an outlook that capex plus investment I repeat so that last time there were some doubts from some of the analysts. We had given an outlook at the beginning of the year, the total capex plus investments that we will have to do into joint venture on associates and subsidiaries would be an amount of 500 Crores, we believe that we will stick on to that number pretty comfortably in the current year.

**Kapil Singh:** Sir net debt reduction how much would it be from March levels to now?

**Gopal Mahadevan:** I think from March levels the net has actually gone up but the reason has been that what has happened in the month of March we had a negative working capital coming in and while all of us felt

happy about it if you were to rewind to what I said in March, what I said I had mentioned that there were significant customer advances that came in because of the March year end because customers were expecting a significant price hike from the industry, the advances that we received from the customers actually resulted in the working capital being negative but overall if you look at it the cash from operations other than working capital has been growing, our working capital in the month of March was operating working capital was 323 Crores and today we are at 603 Crores but the point is we are very comfortable with the increased volume and these are not to be seen as absolute numbers because working capital has to be measured as number of days of sale because when the revenue goes up even if your number of days is constant the absolute working capital go up but if you look at it this is one of the lowest working capital that the company has had and so we are at five days working capital, now this quarter therefore we have actually seen a cash generation of nearly 823 Crores coming in because in Q1 the working capital levels were higher and our debt equity is at 0.7:1. So my total debt in books today is just a shade above 3000, it is about 3021 Crores which we are very comfortably positioned.

**Kapil Singh:** Sir how much do you plan to repay by the end of the year?

**Gopal Mahadevan:** Let us see I mean I don't give any forecast on terms of the cash flows for the year but I think basically directionally what we have been telling is that we should be maintaining these kind of debt equity levels anywhere between 0.5:1 and that is what we would do. See a lot of this also would depend on the working capital strategy that the company would adopt, that could be certain amount of preproduction which will mean inventory levels can go up, we can also possibly downsize the inventory in a particular quarter, this is all going to depend on how the market behaves. But overall I would leave this thought to the investors is that we are very comfortably placed in terms of a debt situation and very, very far away from the 2.3 times debt equity that we had about two years ago we are at 0.7 today and I don't think there is any concern on that issue at all.

**Moderator:** Our next question is from the line Pramod Kumar from Goldman Sachs. Please proceed.

**Pramod Kumar:** Thanks a lot Gopal and congratulations on excellent set of number. My first question pertains to the full year growth Gopal because the first half has been outstanding and I think commercial vehicle sector remains one of the bright spots in the automotive industry at this point of time. So I just want to understand how do you see the second half of the growth and to that extent to understand how much has been the kind of effect of pre-buying in the month of August-September and to an extent even in October. So if you can throw some light on the underlying industry demand and the growth for the full year that will be great and also based on that what is Ashok Leyland numbers going to be like in terms of full year growth?

**Gopal Mahadevan:** First I would say that yes I agree with you that the CV industry has grown a pretty healthy growth in the second quarter as far as H1 is concerned but we must also remember I had mentioned in the last

quarter in absolute terms the number has grown, the growth rate has also been, because of the base effect that has happened in Q1 and Q2 last year. If you remember in Q1 of last year which is FY'15 I repeat Q1 of FY'15 there was actually a degrowth of 10% that happened and then after that the commercial vehicle industry started to pick up from Q2 onwards so to an extent there is a base effect when you see these growth rates that are happening in 43% for Q2 and 34% in H1 but you must also understand that this has been an industry over the last two years I mean leave the previous year that I think finally the industry grow at about 16% for the year as a whole but if you were to leave that previous year the industry has actually seen a steep decline in total industry volume by nearly 50% and in an industry which was at 350,000 units came down to 200,000 so there has been a certain amount of pent up demand that has been catching up and we have also seen that the replacement demand has been there especially in the trucks. The second reason that we have seen that growth happening is because net freight rates have improved because of the significant decrease in diesel prices. So the net disposable income in the hands of fleet operator has significantly improved, the economics of operating a fleet has improved. We have seen repayment, I would say repayment events with commercial vehicle financiers have also significantly changed, NPAs have come down. So there has been an overall reason for which the commercial vehicle industry has been growing. Now from here onwards I believe that while the replacement demand will continue for some more time to come I think the general expectation is that the economy would also start to turnaround in Q3 and predominantly in Q4. Our forecast at the beginning of the year and we would still want to pursue with the forecast for the want of any better numbers is that we had mentioned that the numbers this year we expect the overall industry to grow at about 20% or slightly upwards I would still continue to maintain that forecast and then we will wait and watch how Q3 pans out. But yes it has been a good first half and there is no denying the fact.

**Pramod Kumar:** And for Leyland in particular because it looks like you guys are on track to beat your previous peak this year itself whereas the industry might do it next?

**Gopal Mahadevan:** We will have to wait till the year end to watch, I can't give you any forward looking statements but I can only assure you that the company is doing everything it should and it can and it will in terms of addressing customers, improving the service network, reducing the downtime of vehicles, disruptively improving the quality, reducing material cost, we have been also reducing or kind of optimizing our overheads, have a clear focus on cash flows and all of this has actually resulted especially the network expansion that has happened and the latest generation of vehicles that we have introduced and the changes that we have made to the vehicles have actually seen that Ashok Leyland is truly a pan India company today. I mean in all regions we are upwards of 23-25% market share so for us the pan India presence has also helped us and I am also happy to share that the production in Pantnagar did record high in the month of September. We are trying all that we should be doing and we will pursue with these strategies of improving the operational efficiency of the company and as well as addressing the requirements of the customers. But like I mentioned one of the most important thing that I mentioned

in the beginning is we are very clear that we would pursue anything especially market share only profitably.

**Pramod Kumar:** And my last question pertains to the capacity Gopal because I think given the amazing run what you were having you probably will be short of capacity probably by towards the end of FY'17 on a quarterly basis, just so that I am looking at the right numbers, the current scalable capacity is 175,000 including all the facilities and including LCVs is that right?

**Gopal Mahadevan:** No our capacity is about 150,000 excluding LCV and you know I don't see an issue on capacity immediately because we can actually augment capacity by actually running extra shifts and also debottlenecking certain critical aspects of the plant. Now are we going to incur a huge amount of capex on that, I believe not so I am not too concerned about capacity for the next couple of years at least.

**Pramod Kumar:** So probably the new plant or new big capex would probably more in FY'18 rather than FY'17 or anything like that?

**Gopal Mahadevan:** Even there I am not going to say there are new big capexes, I think we are very clear that we will augment capacity and there are multiple strategies for augmenting capacities. The strategy of the company has been actually slightly different over the last three four years. We have decided that we will only manufacture what we design and we will design only what we can differentiate. So we are also looking at opportunities where we can work closely with vendors to ensure that a part of the capacity is actually deriving out of their facilities. So it is only the core capex that we may want to put within our company where we believe that we can add significant value in adding the capacity than actually giving it to a third party. So our manufacturing strategy has also evolved over the last three four years and that's why we have been able to, see one of the most important thing you must also remember is not only the kind of volumes that we are generating in the market but also because the manufacturing capabilities that we have been able to display in terms of the stepping up of quick ramp-up of manufacturing that has happened. So the way we manage the supply chain and the way we manage the manufacturing is also distinctly different from what it was in the past.

**Pramod Kumar:** Excellent Gopal, good to hear this welcome change because I was bit more worried about if there going to be a big lumpy capex which is going to hit us in '17-'18 because of a new Greenfield plan or something but I am happy to hear that you are going to be much more leaner than in the past.

**Gopal Mahadevan:** Yes, I mean the intention is going to be very clearly to be lean, so we will only invest on what is absolutely necessary and we are not going to ignore anything where it is going to kind of deprive us of strategic advantage also. We are neither going to be conservative nor are we going to be optimistic we are going to have a very realistic policy towards capex.

**Moderator:** The next question is from the line of Sunil Gupta from UBS Securities. Please proceed.

- Sunil Gupta:** Good morning Sir, thanks for taking my question. Sir I am still slightly puzzled by the fact that if you look at the fact that you have about almost MHCV growth year-on-year of 64% and your top line has grown year-on-year by 55% and despite the fact that we have seen improving realizations and improving mix on the MHCV side so could you sort of I mean any other factor, has the discounts gone up, anything of that sort?
- Gopal Mahadevan:** Actually I am not clear about your question. I didn't understand what you were puzzled by because I thought the operating leverage has quite clearly trickled down to the bottom but I am happy to answer your question.
- Sunil Gupta:** No I am just saying that like in the first question itself like the net sales is up year-on-year 55% versus your MHCV volumes year-on-year at 64% and clearly your realizations have improved year-on-year and your mix would also have improved with higher tonnage coming in, so should not we see at least the sales growing in line with the volume growth, that is what my question is?
- Gopal Mahadevan:** See the sales growing in line with volume growth is going to depend on the mix, very clearly see because when the volumes grow up, the discount levels have marginally gone up but like I have mentioned in the past what we do monitor is we see whether the net price realization for the vehicle has gone up or not. I should not be stating it but we possibly are the only manufacturer who has been stepping up the pricing increases pretty regularly, so there have been discounting strategies that have been adopted in the market, so we have ensured that on a net basis quarter-on-quarter the net price realization that ensues to the company is positive. The absolute terms if you were to just divide the total revenues by total volume it will not come in because there are spares business, there is defence business, there is LCV business and there is also an exports business, so what happens is in a quarter for example in this quarter I did mention that our exports was a tad low, now we had quite a chunky export coming in the June quarter which I did mention, so that actually had an effect of the gross margins to be slightly better but if you look at Q2 versus Q2 my material cost versus sales was 73.6% in Q2 last year, this quarter it is 70.4%, so there has actually been a 3.2% reduction in material cost.
- Sunil Gupta:** Would you be able to give us something on the average discount number what was it for this quarter?
- Gopal Mahadevan:** The average discount numbers, they continue to rein high, they have not actually come off, if you really look at it the discounts are in the range of about 2 to 2.25 lakhs, in some cases they have gone up, now, the reason the discount is happening is not because we want to initiate it but sometimes we are expected to match the market in terms of offering a discount but what we do is to ensure that we neutralize the negative impact that the discount have on revenues by actually increasing the prices, so my net price realization has actually improved from Q1 to Q2.
- Sunil Gupta:** Could you tell us how much was the price increase that you take in the second quarter and then post this ABS implementation what has been the sort of price increase?

- Gopal Mahadevan:** I think we took a 1, 1.5% price increase in the second quarter, we did that in the first quarter also and as far as the price increase that has happened in October because of the regulations I think we possibly are the only commercial vehicle manufacturer who has actually passed on the cost, because these are genuine costs, these are driven by regulations, we have done that.
- Sunil Gupta:** How much would be that 2% or what sort of a number?
- Gopal Mahadevan:** 2% but I would say that typically the average would be something like about 70 to 75000 because certain changes are applicable only in the north like the NCR region, BS IV implementation would cost about 60,000 rupees, but it is not there in the rest of the country, but you have ABS, you have got Speed Limiting Device (SLD) which all of it may cost about 35000 rupees, so the price increase will depend on where the offerings are being made what are the regulations that are there, so the rates can be anywhere between a 30-35 to about 80-90000 rupees but whenever this new regulations have come in we have passed it on.
- Sunil Gupta:** Sir on the capex you are still holding to 500 Crores sort of a number although the number for the first half is much lower, so anything that you are looking at in terms of where are you investing the capex because you don't need to invest in capacity now?
- Gopal Mahadevan:** I need to clarify I did mention that when I shared the numbers this capex plus investment and subsidiaries, this is not purely capex. We have our capex budget and we have certain requirements to fund subsidiaries because they require financial support, so we believe that we will be well within that number within the year end but otherwise the capex that is being done let me assure you most of it is debottlenecking or select niche strategic capex which is not very high value at all but which can actually release capacity or improve efficiency. It pays itself back very quickly.
- Moderator:** The next question is from the line of Amin Pirani from Deutsche Bank, please proceed.
- Amin Pirani:** Hi Sir, thanks for the opportunity, sir my question is on the impairment that you have taken for the John Deere JV, after this impairment what does it mean for the products that you are developing jointly and what is the roadmap for the future launches in that segment?
- Gopal Mahadevan:** I can tell you that we reviewed the performance of the joint venture and volume that was being done and then we mentioned that, I don't remember, but I thought in one call earlier I had mentioned that we are taking some reviews of some of the ventures and we would take a decision at appropriate moment in time as far as impairment decision is concerned, so we decided that first we will have to do is to take an impairment, so we have actually impaired it to the value of the net book value that the JV looks like. We have taken that 157 Crores which will bring down the investment to the net book value which is there as on September 30. As far as the future plans for the JV is concerned I will not be in a position to comment on this because it is a joint venture and any statements on the joint

venture or its plans can only be done after the discussions on the same are completed with the joint venture partner.

**Amin Pirani:** So as of now the joint venture is still there and you are still developing products, what your future plans may be would be known after some time?

**Gopal Mahadevan:** What is called as a backhoe loader and two variants of it, we have never developed anything significantly after that because the plan was to introduce these two products.

**Amin Pirani:** Sir just on your capacity just to clarify this 150k is broken up between 50000 in Pantnagar and 100,000 in Tamil Nadu, is that called.

**Gopal Mahadevan:** Broadly yes but then we have also certain other capacity, not truck manufacturing or vehicle manufacturing; we have Alwar and Bhandara also.

**Amin Pirani:** Can you give us a sense of what the run rate you are doing in Pantnagar right now, broadly for the first half or for the quarter whichever you are comfortable with?

**Gopal Mahadevan:** We just bridged 5000 units in the month of September but it was required because a lot of this depends on supply chain strategy because we need to decide depending on the order which plant has to be activated for what capacity, so as I had mentioned earlier in the call as well I don't foresee capacity as a constraint in the near future, we are keeping a close tab of it, we are reasonably comfortably placed. We can do a debottlenecking actually to increase the capacity we believe so there is no immediate concern on that.

**Amin Pirani:** Lastly the excise duty benefits in Pantnagar are FY 2018 the last year for it or does it go beyond that as well?

**Gopal Mahadevan:** FY 2020 is the last year for it. March 2020 is the last month for it.

**Moderator:** The next question is from the line of Basudev Banerjee from Antique Finance, please proceed.

**Basudev Banerjee:** Thanks sir for taking my question and congrats for great set of numbers, couple of things, last year we remember you did some impairment from under Nissan JV, this time under John Deere JV, so any more such in the pipeline in the coming quarters if you can highlight Sir?

**Gopal Mahadevan:** Nothing that I can disclose at the moment but I will tell you only one thing that we are very clear about the strategy of the company, the overall strategy of both Ashok Leyland and consolidated would be very clear. We would pursue with businesses which we believe will be accretive to Ashok Leyland, we will pursue our businesses which we believe we can drive to a path for profitability so where we find that some of these businesses are not giving us the desired results we need to do two

things, one is we need to see how to pursue some of these business and same time we also need to be clear about the accounting processes that we need to follow, so that is the reason why there is impairment.

**Basudev Banerjee:** Second thing sir, after this IndusInd Bank share sell how many shares are left now?

**Gopal Mahadevan:** We have 32 lakh shares left.

**Basudev Banerjee:** Sir as you said earlier in the call that your staff costs were very much in the subdued side when the weaker demand was there and now when things are improving so you are taking care of your staff but still sir on a sequential basis we know volumes have moved up significantly but absolute staff cost inflation of 15% so was there any annual bonus distribution or any pension accounting if you can highlight because if we see from March quarter your annual wage hike already got reflected from 280 Crores to 330 and that also remained in June quarter, so suddenly from 330 Crores for two consecutive quarters it moved up to 380.

**Gopal Mahadevan:** I would only say one thing, the staff cost going up, you must remember there are two three aspects to this, one is one year back actually there was a 5% cut in payment the management had taken, let me clarify, we are not really kind of splurging on staff cost, the management had taken a 5% cut which was then reinstated somewhere in the mid of last year, now that effect will also start coming in the full year to great effect in this year and second thing is there were no significant raises that the management or staff got over the last, I am not talking about last year but year before last there was no significant increase, so we have to ensure that we are able to retain good talent and motivate people as we move forward. We are doing that even as we reduce numbers. You must remember that we reduced almost a tenth of the management staff in the quarter October 2013 to December 2013, so and from that level the company has actually moved from a 9900 Crores to a 13500 Crores company last year and given the kind of trend that we are looking at you understand that there is a growth path that the company is evolving for itself in the current year, given that we have to ensure that we have to reset some of the disadvantages that the staff and management have faced over the last two to three years and we have to remain competitive and there are no pension entries or anything of that sort that has been done but we have accrued certain amount of bonuses that we will have to pay given the performance of the company and we thought that it is prudent that we will start accruing it when we see that we have some visibility on it, that is why.

**Basudev Banerjee:** Then will it be right to assume that bonus payout is an annual stuff which was accounted in one quarter and so in next Q3 where volumes will be subdued your quantum of staff cost can come down slightly?

**Gopal Mahadevan:** I don't think that assumption would be right because that would not be an appropriate method of accounting right, I cannot accrue something or deplete something in one quarter what pertains to the

full year but I think what we will have to keep resetting and I cannot delve in to details here is that we will keep readjusting the manpower cost depending on the visibility that we have as to some of the provision that we have to make and as I talk to you we must remember that there could be certain raises that are contemplated which we have some visibility to which may come and hit us possibly or will impact us in Q3 or Q4. It is prudent that we start pulling it forward to ensure that we are making provisions for it.

**Basudev Banerjee:**

Sir last thing what kind of blended tax rate will be prudent from a future perspective?

**Gopal Mahadevan:**

I think it will be very close to the standard tax rate which we have which is about 32% or 33% because I think the effective tax rate and the standard tax rate is pretty close, I don't think there are any huge advantage that any organization gets today given that the levels of exemptions and tax benefits that are available are not very significant.

**Moderator:**

The next question is from the line of Sreenath Krishnan from Sundaram Mutual Fund, please proceed.

**Sreenath Krishnan:**

Thank you sir for the opportunity, you mentioned that to move to BS IV you would have an incremental cost of 50,000. In the past interactions you had mentioned that you would not be needing a common rail but you are working on a solution below that, so how are you meeting current BS IV emission norms?

**Gopal Mahadevan:**

We have got the capability to meet BS IV.

**Sreenath Krishnan:**

No I was talking about, you do have with Neptune engine but you mentioned that you would be developing a cheaper option rather than moving towards a common rail.

**Gopal Mahadevan:**

No, what we mentioned was we are working on developing that but as far as the current emission norms are concerned we have all the exhaust capabilities that is there plus we must remember that even for the higher grade of emission norms if it happens sometimes in 2018 and 2021 we also have the capability at the moment we have already upgraded our exhaust systems and engine capability to the current emission norms, we are looking at alternatives but we will announce that once we have kind of tested it and we are ready to roll out those capabilities.

**Moderator:**

The next question is from the line of Hitesh Goel from Kotak Securities, please proceed.

**Hitesh Goel:**

Thanks a lot for taking my question Gopal and congratulations on good set of results. I just wanted to get a sense on the working capital, you highlighted that by the end of March last year you were at negative working capital but there has been a huge swing in terms of working capital some part of it is explained in sales increase where your investors and trade receivables have gone up but your trade payables have not come down, so basically it is flattish, it has not increased basically with sales, so just wanted to get a sense what is happening there?

**Gopal Mahadevan:** It is very simple, actually not some parts of it; all part of it is linked only with the volume increase and nothing more than that.

**Hitesh Goel:** The trade payable is flattish right on a March to September basis, it should also go up with sales right?

**Gopal Mahadevan:** You see the trade payables will be a factor of again the mix of steel and other vendors and etc., like that, so when we look at it in number of days of course the payables have marginally come down because of certain payments that we have had to make but the predominant part of the working capital has gone up because even if I were to have the same level of inventory days the absolute inventory will go up and the same thing would happen with my receivables, so when you look at my operating working capital which is there in March it was negative again I repeat in March it was driven by customer advances that came in for prebooking some of the vehicles, so that resulted in the operating working capital absolutely becoming negative and instead of being celebrative about it I had actually warned investors saying that please take that as a favorable blip in the radar, don't expect negative working capital to be pursued as we move forward because the situation will actually correct itself very shortly, so for me if you really look at it, the reason why the working capital has actually gone up has been as vis-a-vis March is that the volumes have gone up, that is the reason why the OWC has gone up but on a sequential basis if you were to look at the working capital it has actually come down, from Q1 it has come down, so actually if you look at the numbers it has come down to five days, so we have actually been able to rein in the working capital which is why it has resulted in the cash flow that I had mentioned earlier, we generated about 823 Crores of cash.

**Hitesh Goel:** My second question is on other expenses, we have seen a 46% growth in other expenses on first half basis versus 54% growth in topline, so the operating leverage is not playing out in the other expenses, I know that major part of this other expense is selling and distribution, so we should keep the other expenses in line with the sales growth should that be the focus or is there scope for cost reduction there?

**Gopal Mahadevan:** Other expenses also includes because of accounting classification the other expenses also includes certain exports, export related expenditure, they are not relatively product cost but when we do these exports there are certain costs that have to be incurred including certain associated services to the basic vehicle, there has been for example investment in the ticketing system that we have to do, we have to do some training of people, we have to maintain certain spares of not stock but we need to maintain spares, inventory outside for which there are costs to be incurred and then of course there are sales commissions to be paid, all of this has actually resulted in the other expenses going up but otherwise if you look at it we had embarked on a cost reduction program about one-and-a-half years back where we wanted to reduce our breakeven. All the normal G&A and administrative overheads are all within line with those norms, but there could be some lumpy numbers coming, it is not that if were sales were to go up my G&A will go up but sales related expenses if there are anything which

actually helps in getting the contract would actually go up, so that would depend on the contractual terms that we have not only for exports but also for domestic business.

**Hitesh Goel:** My final question is on the steel cost increase, there has been an increase in import duty by government, the domestic steel guys have not yet increased the prices but they will subsequently increase price in third and fourth quarter, have you started seeing the escalation already?

**Gopal Mahadevan:** I have not seen an escalation but you must remember that the government duty I believe it is 20% or so has been actually done to protect the domestic steel industry but globally the steel prices have come off significantly, I am not too sure whether there is price increase on the anvil or not, we do not have any visibility on that but at the moment we have not seen any steel price increases. It decreases as well because I think domestic commodity or any bought out would bench mark the pricing based on the landed cost of imports.

**Hitesh Goel:** Yes, but I think the government has subsequently increased the duty further by another 10%. Okay, no issues thank you.

**Moderator:** The next question is from the line of Aditya Ahluwalia from Invesco, please proceed.

**Aditya Ahluwalia:** Hi, thanks for taking the question, I have a few, first of all if I missed it, are you sharing any expectations on the second half volumes for FY 2016?

**Gopal Mahadevan:** No you did not miss it, we did not share any expectation and this has been consistent with our practice in the past, we actually don't give a guidance for the performance of the company for the year end but what I did mention when they asked about question on the industry growth we maintained that we will continue to maintain what we have mentioned in the first quarter, I believe that growth rate of the industry for the year as a whole should be upwards of 20% but we will wait and watch.

**Aditya Ahluwalia:** And we will beat that growth?

**Gopal Mahadevan:** Well we will try, we are not deliberately planning to shed our market share but we will pursue only meaningful market share so I think what we would want to do is to see whether we can stay back where we are but ultimately what we will look at is profitable growth, that is for sure.

**Aditya Ahluwalia:** My second question is for most companies that I track normally the companies look at staff cost as an absolute number an inflationary increase and then if you are adding distribution or marketing to an extent absolute numbers, however you said that you look at staff cost as a percentage of sales, I just wanted to understand what is the reason behind that and should it not be looked at as an absolute number in the way I described it first, in your case I understand there was a reset that you explained because of pressures in the past, so is that reset now through and going ahead can we project it like on

an inflationary basis plus expansion or if it is a percentage of sales then can you give us a guidance on what percentage of sales?

**Gopal Mahadevan:** See I will put it this way, there are multiple ways to actually look at staff cost. The first one in our case we would have to look at it historically as to where we were and where we need to be to be competitive, not that we are uncompetitive but we are becoming increasingly more and more competitive and we are seeing that the attrition rates are getting lower, the second part of staff cost is to also see where we are vis-a-vis industry and you have to see on a grade basis as to where are we for a particular grade vis-a-vis industry, that is the second part of analysis of staff cost, the third part of analysis of staff cost is actually to because there is a fixed and variable portion of it and in a year where if suppose one is expecting that internal targets will be met then we also have to start accruing for bonuses and variable from the quarter when we start having a visibility on it. I did mention earlier that if we see that there is a revision in the visibility that happens then we also will suitably adjust it, then comes the fourth part it which is the absolute quantum that you see as to this staff cost has moved from x to y and if that is appropriate given the industry, is it appropriate given the company, is it appropriate given the size and the growth of the company and last aspect of it is of course to look at as a percentage of sales, so when I said that one should look at it as percentage of sales what I mentioned was that possibly the investing community should look at as a percentage of sales more than just looking at the absolute amounts because very clearly in staff cost the operating leveraging kicker has been pretty high I mean the sales have grown at say 54% and staff cost has actually grown by X percent but we have to look at and when you look at it as a percentage of sales sequentially actually it has come down, so one has to look at all the areas, now the first four of the staff cost the aspects of reviewing staff cost is purely internal, the last aspect out is what we can share externally. I don't think there is anything rude shock that you guys can expect to have in a staff cost at all, for me it is not a significant cause for concern at all, let me clarify.

**Aditya Ahluwalia:** So on a grade basis now are we at par with the industry?

**Gopal Mahadevan:** Well, we are trying to be, I don't know whether I can say that we are now on par or better or best because it is a very complex thing, I cannot tell it in one answer actually to be honest with you in one shot but we are competitive, let me tell you that, we are competitive, we have been able to get some very good talent in to the company, we have been able to also retain some of the better talent in the company because typically what happens is that in a uncompetitive situation it is always the best talent that you lose, so that is very critical and important to have and these resets keep happening year-on-year, it is not a constant factor and then when you also have a variable pay attached to it, this becomes a little more unpredictable and if you have a history like what has happened two years ago when there has actually been a reduction in manpower, there has been a cut in pay then the predictability of that or the sequencing of that becomes even more difficult, that is where when you look at the staff cost in absolute terms you see this fits and jumps that is happening.

- Aditya Ahluwalia:** I understand, thank you so much for the detailed explanation. On the other expenditure as well can you give us some indication of what percentage is fixed in nature and what percentage of the other expenditure is linked to sales in a way approximately will do fine?
- Gopal Mahadevan:** I would say that out of the total expenditure I would say about 30% to 40% of it would be linked to sales because you have freight, you have commissions, you have other expenses directly linked to sales and after that of course you have the rent, electricity that would be the range and then you have production overheads, so it could be even a 50:50 to be honest.
- Aditya Ahluwalia:** On the tax rate we had a 20% tax rate in FY 2015 and now you are guiding for 32, 33% tax rate am I right?
- Gopal Mahadevan:** Because we had a loss overhang and then there was some adjustment that we had to do on the long-term capital loss and adjustment for long-term capital gain all of which got and the deferred tax adjustment all of which actually resulted in lower tax rate but as we are now moving out of MAT and then you are moving actually to normally tax rate at that rate also I had to clarify we were in MAT, now we have actually moved out of MAT and we are in normal tax and when you do that the effective tax rate would be close to the applicable marginal rate of tax.
- Aditya Ahluwalia:** I see so 33% is what we should build in?
- Gopal Mahadevan:** Yes 32 to 33%.
- Moderator:** Thank you very much, the next question is from the line of Raghu Nandan from Quant Capital, please proceed.
- Raghu Nandan:** Thank you Sir for the opportunity, congratulations on superlative performance, sir in addition to replacement demand how is the trend in fresh fleet additions by freight operators, also request your comments on demand trends in mining, road construction segments and lastly also your outlook on the exports, thank you.
- Gopal Mahadevan:** I think I will do the following, first if you look at it, I did mention about the pent up demand that has happened because the industry actually degrew by nearly 50% till FY 2014, so we had a total industry volume of 350,000 which came down to 200,000 and by the way we are still not come to that stage where the industry volume has reached 350,000, so there is still I would say an upside in terms of reaching where we were about three-and-a-half years back, so it is good to actually see the growth that is happening in the industry, the reason for the growth like one was the pent up demand, the second one has been that the diesel prices have come off and we are actually seeing the freight rates becoming better, so when this happens the replacement demand also starts kicking in because economically and financially a fleet operator finds better sense, it makes better sense to actually invest in to a new vehicle because some of the larger fleet operators would not want to have a vehicle

which is more than three to four years old because they would want to have a fresh set of wheels to service the customers better because then logistically it becomes, they invest lesser time on the making of the vehicle, now the third aspect of it I think we have also seen that given that the freight economies have improved we are actually seeing also a lot more first time buyer, first time buyers first time users actually coming in, so that also kind of improved the demand. The last aspect is in select niche industries like oil for example, refineries or FMCG some of the customers themselves have insisted that the fleet operators actually replace their existing fleet why that is because logistics cost has become a very, very important piece in the supply chain cost and the entire product cost of all these end customers, so logistics plays a very important role and more importantly logistics is not only about cost logistics is also about time, so they are actually mentioning that they want to have vehicles which are compliant with regulation with a faster turnaround time, who are lower down on maintenance and they want to ensure that the fleet operators have got a fresh set of vehicles available to service their requirements. The last one of course is what you touched upon, you know while we are yet to see the economy actually start moving down the path of accelerated growth I think there is a general belief that it is warming up its engines and we would actually start to see some benefit of this coming up especially in the fourth quarter, we have actually seen that the growth has been in haulage, in the first six months the growth has been in haulage, it has been in tractors and multi-axle vehicles and as we move forward we believe that there will be a traction that will happen in tippers as the mining activity, the deregulation that has happened in the mining I think so there has been a certain amount of buying that has started to commence and we expect that once the opening up of this sector happens in the second half especially in the fourth quarter that is the input that we are getting then we would actually see the demand going up. There has also been a lot of activities that has happened in the infrastructure side especially on roads and that is again why we actually see the tractor trailer and multi axle vehicle growth coming in because some of the contracts are getting reissued, some of the people are reviving their projects, so the fleet operators and the truckers want to ensure that they don't miss an opportunity of getting those contracts when they are getting issued out, so hopefully this trend will continue and if all these four or five aspects do happen then we do see the industry growing but of course I think it is important that the economy grows, at the end of it, there is nothing like core growth happening, the core sector has actually seen some oscillations but in August it was 2.6%, so hopefully things will start improving and there is nothing to beat economic revival and GDP growth actually to drive up growth of not only the commercial vehicle industry but also the rest of the industry including desi goods.

**Raghu Nandan:**

Thank you Sir, that was very helpful and your outlook on export side and if you can also share the dealer inventory levels that will be helpful.

**Gopal Mahadevan:**

The dealer inventories are very much in control. As far as our inventory is concerned in the month of September I think we were at about 7600 units which is may be about a 1000 units more than what we would have normally had but this was very much planned inventory depending on some of the orders that we have to service in the month of October and November so we had to plan our schedules

accordingly because we cannot just produce trucks or buses as and when we want because especially in bus if you look at it we need to produce the vehicle, then it has to go to bodybuilding and by the time it comes out it takes another 30, 45, even 60 days, so there is certain amount of production planning that gets in to this. As far as exports are concerned I think while we have been a tad low in the current quarter I think we would catch up in the end of the year, so we would actually have possibly have exports being about 15-16% of the revenues is what we are targeting but I cannot give this as a forward looking statement but in the medium term I would say that the company is looking over the next three to five years as I had mentioned earlier in our calls as well, we are looking at exports being key element of our strategy, we want exports to be at least about a third of our revenues, the reason why we want to grow exports and some of the other businesses other than basic truck business, domestic truck business is because we are pursuing efforts in defence, spares, the power solutions business and buses and exports because that way the company would get de-volatized secondary to sinusoidal waves that the domestic truck industry goes through, you have periods of feasting and fasting that happens in this industry and so we want to ensure that we are able to smoothen the curve as much as possible.

**Raghu Nandan:**

How do you see the defence orders panning out going ahead because initially you mentioned that this quarter had a lower share of defence?

**Gopal Mahadevan:**

That was the supplies, I cannot give some details but we are very positive about the defence business, it is a very key element of our strategy, we are attempting to disruptively grow the defence business today what we are doing is we are only in predominantly in transportation of people and so we are now looking at how do we scale this up quickly to not only transport people but also to look at transporting equipment. While we will never manufacture artillery, we are building capabilities as I am talking to you to also have launches for transporting some of the larger guns, so again let me clarify very explicitly we are in the transportation solution of business and we are not in the armament side of business, we are pure logistics players but even there, there is a huge opportunity and given the fact that we are one of the largest suppliers to defence we believe that we do a strategic advantage and in some of the recent tenders we have been selected as L1, so we are pursuing with those tenders and we are also looking at selective tie ups for technology for some of these vehicles because some of these vehicles require capabilities which possibly need to be augmented aside of our existing technology itself, so it will be actually the strategy we are looking at is actually two ways where we can use India as a manufacturing location for exporting some of the specialized defence vehicles, at the same time we will also acquire capability so that we can serve our Indian defence better.

**Moderator:**

We will take the last question now which is from the line of Sahil Kedia from Barclays, please proceed.

**Sahil Kedia:**

Thank you for this opportunity. I have two questions sir, firstly you mentioned that your production in the Pantnagar plant has gone up to about 5000 on a monthly basis, this is already higher than what

you have in terms of a full year capacity which is 50,000 so I just wanted to understand Sir when you mentioned about debottlenecking how much per annum capacity can we expect from the Pantnagar plant, are we running at pretty much full capacity right now?

**Gopal Mahadevan:** Well, I would say that we are running at reasonably optimal capacity but we are looking at opportunities to de-bottleneck this but I will not be able to share the number to you because we are looking at various options there, see it is not like we have to upgrade every aspect of a plant, this is actually not only the production line but there are also ancillary manufacturing capability that we have to put in so that the overall manufacturing capacity goes up, so at the moment we are looking at opportunities to actually increase the capacity further but I cannot actually share as to whether I can produce X thousand units or Y thousand units in the next two months. We will share that at an appropriate moment of time once our strategy pans out.

**Sahil Kedia:** Sir with the change of BS IV and also ABS being made compulsory have we passed on all of that to the end customer by price increases?

**Gopal Mahadevan:** Predominantly yes.

**Sahil Kedia:** Sir what is your expectation going in to next year for the defence side in terms of the normal growth that you expect not for the new businesses that you are developing but your existing supplies do you expect that growth to be 15-20%, in the sense I am just trying to get a sense of what that growth should be growing in to next year?

**Gopal Mahadevan:** Lot of this, if I had the visibility rest assured I would have shared it with you. We are optimistic about it but I can share that number only in the later part of the year which will possibly be in Q4 because a lot of this depends on ordering by the industry for the department, so until then they will also close their orders, first of all they would be particular about closing the budgets for the current year, they have budgets running for the current year they will close that, so once we get some visibility we can share but we are positive that with the focus that has been there on defence order it should be possibly higher than what it was in the current year but we will have to wait and watch.

**Moderator:** Ladies and gentlemen on behalf of Batlivala & Karani securities that concludes this conference call; thank you all for joining us and you may disconnect your lines now.

**Annamalai Jayaraj:** Thank you. On behalf of B&K Securities we thank all participants for joining the call and special thanks for Ashok Leyland management for giving us the opportunity to host the call. Have a good day.