



“Ashok Leyland Q3 FY17 Earnings Conference Call”

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Moderator: Ladies and gentlemen, good day and welcome to the Ashok Leyland Q3 FY17 Earnings Conference Call, hosted by Edelweiss Securities 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. In case you need assistance during the conference call, please signal an operator by pressing ‘*’ then ‘0’ on your touch tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Karthik Subramaniam from Edelweiss Securities Limited. Thank you and over to you, sir.

Karthik Subramaniam: Good morning everyone. On behalf of Edelweiss Securities, I welcome you all for the Ashok Leyland Q3 FY17 Conference Call. Representing the management team, we have with us Mr. Gopal Mahadevan – President (Finance) and CFO. I now hand over the call to Mr. Gopal for his initial remarks and then we can start with the Q&A session. Over to you, sir.

Gopal Mahadevan: Thank you very much. Good morning to all of you and I have with me Mr. Rakesh and Gopinath also joining in the call. Balaji is away on some training, so he has not been able to participate. So, that kind of also kind of signifies the efforts that people are in the company is putting in leadership development. On that note, I will just give the brief details of the current quarter and I am going to share both the good stuff and not so good stuff, so that it sets a perspective.

I think the current quarter was in terms of general economic condition was as all of us know was faced with a lot of turmoil, the demonetization impact that came in early part of November, sucked all the cash out. And the reason I am mentioning this again is because the freight and trucking industry, predominant part of the operations are done in cash. So, be it driver wages or diesel or lube or any other expenses including toll is actually paid in cash. So, when this happens, you actually see quite a bit of effect on the industry and we did see the demand coming off. The total industry volume was negative 3% predominantly by truck and bus actually grew by 30% but that was only because of invoicing of STUs.

Now, if we were to just step back for an industry which grew negatively by 3%, Ashok Leyland has grown 9% in both trucks and buses. We have grown almost equally in trucks and buses. So we have gained 9%, our market share is actually grown from 30.1% to 33.7% in aggregate. So, we have gained about 3.7% in market share. So, if you were to look at it and of course our EBITDA margin was lower by 0.6% from 10.9% to 10.3%. I will also explain why this EBITDA margins were lower but if I were to step back and okay, let me explain that. So, the EBITDA margins were lower because of two reasons. One is the level of discounting in the industry actually grew a lot higher. It typically was in the 225,000 to 250,000 range and this number actually increased to almost 3 lakhs, in fact in certain cases above 3 lakhs per vehicle.

As Ashok Leyland, does not buy market share and does not chase market share. What it tries to do is to add customers. I know this looks like a lot of English, but the purpose is to provide more wholesome solutions and look at the total cost of ownership, how is my service penetration, how is my parts penetration, how is the network penetration happening and then we look at the whole business. Even having said that, I think if you were to look at the performance for the quarter and

yeah, again sorry I had to go back. One is on the raw material and on the price discount. The second effect which was there, so that was a top-down effect that we had on the margin pressure and the bottom-up effect that was there on margin pressure was the raw material price increases. Steel prices have been increasing quite consistently and because of this increase has have also happen because of coking coal price increase going up I believe 4 to 5 times and due to which steel prices, steel prices have also been hiked. And in this quarter, when the industry actually saw volume coming off and then you had demonetization coming in, there was no opportunity actually for Ashok Leyland to increase prices and that was one of the reasons why you have seen them the EBITDA margin coming off.

But having said that, I would also step back and look at this little differently. In the history of Ashok Leyland Q3, I do not know how many of you are aware this is the Q3 in which we have had the highest volume, the highest sales, the highest absolute PBT and PAT. If you like remove the effect of the mark-to-market accounting entry that we have and on the qualitative side we got awarded the Deming prize for Pantnagar. We possibly are the only commercial vehicle manufacturer in the world aside of in Japan to be awarded this and this award exemplifies the effort that the company is continuously making in improving systems, processes, quality and it was a very redeeming quarter for us in that sense.

More recently of course which is post quarter but we have, we also took over the LCV, this was in the quarter which is we took over the LCV business 100% and we are excited by the prospect that the LCV business holds for us. We continue to maintain market share at about 14%-15%. We de-grew LCV by marginally about 3%. You cannot blame the team sitting, the LCV team has been doing a wonderful job because there was so much of uncertainty but they have been able to keep the dealership and the customers and the employees together. So, despite all the uncertainty in the market and what was being said in papers, I think this team has done a wonderful job. So, if you look at it in terms of products, in terms of our milestones, I think the Q3 has been very eventful. Yes, could we have done better on EBITDA margins, it would have been impossible if we were able to raise prices something that we did in the fourth quarter. So, we did raise prices 4% each in trucks and buses and it is the highest in the industry. I do not think couple of players have even raise prices at all. But we believe that we cannot continue to absorb the raw material price increase and continue selling trucks at the same prices.

So, overall if we were to look at it, our cash generation has also been favourable. We have added about 350 crores of cash. My debt-equity remains very stable; the debt-equity is less than 0.25:1, at the end of the quarter. We continue to focus on keep adding our investments and keeping the, the overall tightness on CAPEX and investments. The last, but not the least is something that I also wanted to share with you; the process of merger with HFL is on track. But for the second quarter in a row, HFL has been able to show EBITDA positive and that is very important for us because now the management of Ashok Leyland is also involved in the operations of HFL and hopefully the merger will happen with the necessary statutory approvals.

As we move forward into Q4, we are expectant just like the rest of the industry that there would be quite an amount of pre-buy that will happen because of the Euro IV implementation that will

happen from 1st of April and we are readying ourselves for that. We did build up a certain amount of inventory pipeline, even though in absolute terms my net operating working capital was low and we generated cash but we did have an inventory pipeline to be built in, so that we do not lose production and in the even there is a demand upsurge that we are able to sell the vehicles without missing sales. So, this is where we are. We are on the cusp of a quarter which appears to be promising at the moment and we are also on the cusp of a budget to be announced by the Finance Minister on 1st of February and hopefully that will contain some good news in terms of initiatives that will drive the economy for an investment led growth. But let me stop here and hand it over back, so that I can answer your questions.

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

Ashish Nigam: Congrats Gopal on firm quarter and also for gaining the minority votes for foundries merger. My first question was on margins, so I just want to understand the impact of the LCV business on our current margin or if you can even talk about separately just the LCV profitability right now and how much it can improve over the next maybe 12-18 months now that we are controlling it completely.

Gopal Mahadevan: See, I will tell you, at the moment the LCV business the gross margin of the LCV see, there are two parts to this and I am going to answer it very simplistically in the interest of time. If you look at the LCV business per se, the gross margins put together from our manufacturing side as well as from the sales and distribution side, which is actually housed in Ashok Leyland and if you look at the gross margin at the company side, now today they are 100% companies, 100% Ashok Leyland subsidiaries the gross margin will be in the range of about 25% to 26%. So, they are actually healthier than the Ashok Leyland margins. What we are working on is the cost, because when you have two entities, there are three companies which are subsidiaries and then there is an entity which is doing the contract manufacturing as well as the sales and marketing the cost will be a little higher. But as we move forward, I think in the next couple of years there is no reason why the LCV business will not be as profitable as the M&HCV business and we must understand the other most important thing is that we have currently been having only one vehicle. We have only had one vehicle called Dost. The PARTNER and MiTR we had to kind of there were some disruptions in the supplier's engines due to which it was not possible to continue with the products but the products have resumed. So, as we move forward, what we are actually going to see is an LCV business which will not only have Dost but will have improvements to Dost. It will also have products of expansion of the current range of both PARTNER and MiTR. The PARTNER and MiTR will start cohabiting with the recent introduction of Guru. So that we are filling in the slots in the products, so we have LCV which is a 1.2 tonne, 1.25 tonne vehicle called Dost but we are moving to the higher range, after that we will have Guru and Sunshine, which is the ICV truck and bus. After that we will have Boss and from the Boss we will go to M&HCV. So overall, if you ask me from the margins perspective, I believe that in two years' time this will start becoming accretive to Ashok Leyland.

- Ashish Nigam:** At the moment is it EBITDA margin positive?
- Gopal Mahadevan:** Yeah, very much EBITDA margin positive.
- Ashish Nigam:** Secondly, if you can just talk about the kind of pre-buy that you all are budgeting for in Q4. We are hearing various numbers of 20% growth and 40% growth, etc. So, what number you all budgeting for and consequently what happens to your FY18 outlook considering that Q1 falls off a cliff?
- Gopal Mahadevan:** See, I do not know, I will be very frank with you. First of all, I do not know what is going to happen to Q1 if it falls off I do not know. The only thing is if there is a huge pre-buy and if the budget is not going to be as stimulating as we are hoping it will be then we can see a situation where the economy could actually, if we have a very tepid economic growth or negative growth then we have a challenge in terms of not only Q1, even possibly Q2, if it is not happening. So, I think a lot of things are going to depend on sentiments because especially in the trucking industry it is a lot of sentiments which actually help in pre-ordering, because people are wanting to ready themselves especially on the larger vehicles, they want to be ready with vehicles, so that they can participate in some of the tenders and orders. This is what I see. As far as Q4 pre-buy is concerned, I am not going to hazard a number, because I did for once found a little positive in my first quarter analyst call, where I had mentioned that possibly we will see 15% to 20% growth. Otherwise, I normally do not share such numbers. But I think what happened was that unfortunately from the second quarter there has been only de-growth. So, at the moment, all I can say is that we are positive; we are doing the manufacturing planning accordingly. We are expecting that the pre-buy will add about, some amount of quantity of demand but it is not that I do not have the numbers but it is a little too early to state, you know why? We will get greater clarity sometime in February as to where the pre-buy and how the pre-buy is going to happen.
- Ashish Nigam:** So, just on the related note on the budget, so you mentioned so, right now we are understanding that the government side warming up with the cash for clunkers, etc. because it is seen as anti-poor, which they want to avoid at this time. I do not know, so what are you all hearing about it? Where it stuck and what is the argument for and against it?
- Gopal Mahadevan:** See, as far as this cash for clunkers is concerned, it has been going on for quite some time and you are right, that the single, two truck owners will have a major issue on this. But on the other side you all also have the government putting a huge amount of pressure because of the pollution that is coming through because of vehicles, not just only trucks and so cars and everyone pollutes. So, the point is, where is the government going to draw a line and when is it going to make a decision? I do not think cash for clunker announcement will happen in the current budget. If it happens, it is good for the industry but I do not think it will happen. But, if you look at it in the medium term, again I would say in the next couple of years, two years, three years because there is no definiteness with which I can share this information because I do not know that myself. 2-3 things I see, if the government continues to invest in road building and lying of both primary and secondary roads, it is going to make the road transportation much more efficient. I strongly come from the belief that if things become more efficient you will see more

investments coming into that. This is one. The second thing is certainly this cash for clunker at some point in time the old vehicles will have to be phased out either by force or by necessity. If that happens, I would say that anywhere between 400,000-500,000 to maybe 800,000-900,000 vehicles will need replacement over some period of time. Our TIV today is about 300,000-350,000 units. So, that is quite a bit of additional volume that can come in over the next three, four, five years. I do not know within three years, two years, there is no clarity from the government yet. The third thing is of course implementation of GST. Everybody's going to ask that question, so I am going to steal the thunder from the people who want to ask the question and give our views. If GST gets implemented, we are expecting efficiencies to be driven upwards. If that happens there should be more efficient way, which trucks will pass. If that happens, will it affect demand? I do not believe so, because here if things become more efficient, I think people would want to actually invest in an industry where they are seeing that their cash generating units are moving more efficiently. So, our view is that if you build in more efficiency, you build in more electronics in the vehicle, if you build in more tracking systems, systems that talk to customers, to the fleet operators, to the company, etc., these will only actually enhance the investments. So, and the trucks are becoming more sophisticated and that is good news for the industry, because as trucks become more and more sophisticated, actually our aftermarket revenues and service revenues will start getting more concentrated in the manufacturers. Look at what has happened in the car industry. 25 years ago, these vehicles that were plying an Ambassador or a Fiat could be repaired by anyone. Today, even at the base level some of the smallest cars go back to the service centers because that is where they get service, their engines are a little more complex and that drives footfalls or maybe wheel falls into the service centers and that is good news for us. So I think there is a lot more maturity that the commercial vehicle industry will see over the next 3 to 5 years and that is good for us.

Moderator: Thank you. We have the next question from the line of Jay Kale from Elara Capital. Please go ahead.

Jay Kale: Thanks for taking my question and congratulations for good set of numbers in a difficult environment. Sir, my first question was regarding the discounts. In terms of your historical and going forward when do you see these discounts at what capacity utilization levels do you expect the industry to kind of become more disciplined in terms of discounts? Say, historically what has it, at what capacity utilization was the industry kind of being disciplined in terms of discounts?

Gopal Mahadevan: See, I will tell you this, look at discounts slightly differently because these have come and they have started existing, it has happened in the pass car also except for the extremely new models. You see discounting happening, so there are either freebies that are given or discounts that are given. Now, in truck industry also it has been quite heavy. I see an era where the discounts will continue in the sense that I do not expect discounts to vanish. I do not expect the current 2 lakhs, 2.5 lakhs, and 3 lakhs discounts to come off to some Rs. 10,000. No, I do not expect that to happen, unless demand far outstrips supply which is not the case. I am sure that all competitors are going to put in capacity then all competitors are going to compete in the open market. But the only thing that we stay away from and genuinely I do not want to kind of pontificate or give any advice, etc. but we try to move away from discounting and that is how we have been able to

continue to perform as India's most successful commercial vehicle manufacturer and I think it is the eighth quarter in a row that our EBITDA margins are double-digit. So, it signifies something. I am not treading. I have to work very hard. The team, the manufacturing guys, the sales guys, the operations guys, the supply chain guys, the quality guys, everyone I am telling you, works very hard to keep that double-digit margin and because basically we want to ensure that as we grow, we grow profitably. Now, having said that what we see at Ashok Leyland is what is the improvement in net price realization. So, quarter-on-quarter other than for Q3, we actually either saw the net price realization being flat or we were improving marginally, which is why we have taken a 4% increase in trucks and buses in 1st of January because we just could not have taken it in the last quarter because of the demonetization.

Jay Kale: So, maybe you do not expect these discounts to come down to 10,000, but is it once capacity utilization increases, this could come down to say round 1 lakh, 1.5 lakh or you expect these elevated levels to continue.

Gopal Mahadevan: I think the current elevation that has happened in the third quarter, hopefully there will be some sense prevailing in the market and the things will come down. I do not know the number to be honest. See, I do not want to give a number which I do not know but maybe it will stay at 1.5 lakhs, maybe it will stay at 1.75 lakhs I do not know but that is exactly what it would be good to see that because this whole thing about discounting is highly inefficient. It is not a great way of saying that I will sell my vehicle at 20 lakhs and then I will give you a discount of 2 lakhs and then after that you do documentation for it. It is all highly inefficient way of doing it. It is a very typical Indian way of doing it. I am not trying to deride Indian systems but the point is, it is inefficient. Why should we do that? I mean, it is better to have a price and then have some marginal freebies being given which happen in every sale but after that conclude the sale. Let's hope that that sense prevails.

Jay Kale: Sir, my second question was on your defense revenues and exports. What would be the defense revenues or if you could just give a breakdown of your M&HCV revenue contribution and defense and whether it is going to be bulky in the fourth quarter and typically how has the defense revenues been trended in for 9 months?

Gopal Mahadevan: See, typically I will tell you defense revenues are, they are about anywhere between 3% to 5% of my revenues. My exports this quarter were about 9% to 10%. So, the domestic truck and bus business accounted for about 71% of our revenues. So, the balance is coming from LCV, which is roughly about 5% and then you have aftermarket is about 8% the balance is exports and defense.

Jay Kale: Sir, my last question was maybe if you can just, I mean I understand it is one of the toughest things to do right now for the FY18 volume growth but given your assumptions for pre-buying currently at Q4 and then subsequent decline, say in Q1, Q2 what are you budgeting for FY18 volume growth because there seems to be a wide disparity in the markets or even the industry view of M&HCV growth in FY18?

Gopal Mahadevan: Yeah, I will tell you what we are doing is we are not budgeting anything but we are doing some scenario planning. For example, we are planning for a scenario of Q4 pre-buying. With that Q4 pre-buying we have to be careful about how we plan for it because there is still not too much of clarity but it appears that we should be able to sell vehicles of BS-III in the subsequent year but we should not, the industry will not be allowed to manufacture BS-III vehicles, which is how typically it is done globally. If that happens, our inventory management and supply chain management becomes a lot easier. If the government will say, no, you cannot sell or manufacture BS-III after 31st of March, that is going to be extremely complicated and hopefully that will never happen. The second part is, if there is a quite a huge pre-buy that happens in BS-III vehicles against BS-IV, what we see happening is Q1 could have an impact because obviously Q1 is typically not a great quarter. If we have a huge upsurge in demand happening, then you can see that Q1 can be a very tough quarter for the industry and for including us. But beyond that I think a lot of thing is going to depend on the way the economy is going to grow, what is the signaling that happens, what is the mood and sentiments of people, what is the impact on industry at large, including commodities. So, a lot of this is going to depend on that and hopefully, the other thing that we have to look at is not just only this pre-buying and sentiment. Oil prices are also going to be very important, oil prices have been steadily up ticking and we will have to see where they go because that also has a bearing on our industry and freight rates. I know I have not been able to answer your question directly but frankly, we are also budgeting various scenarios instead of saying this is the number I will reach. It is very difficult to say that because this is like a gaming theory. You need to have various options when various levers are pulled.

Jay Kale: I understand, sir. I think this is the predicament of the whole industry at this point of time. Thank you and all the best.

Moderator: Thank you. We have the next question from the line of Raghu Nandan from Quant Capital. Please go ahead.

Raghu Nandan: Sir, exports have been muted despite order wins. Can you share your expectation in that space?

Gopal Mahadevan: See, despite order wins in the sense that there is certain documentation that has to be done. These are government to government exports and we are hopeful that we will see some amount of export billing catching up in the fourth quarter. I only wanted to say that I am not defending, if something is not correct. But just to kind of share a small factor which is not that we are very happy with it but our exports have actually grown by 11% quarter-on-quarter. So, they still hover at about 9 to 10. See, one thing that I wanted to share with investors is, I will take this opportunity to share it again because there are 2-3 things that we are doing at the company. One is, we want to de-volatize Ashok Leyland then have it as a steady kind of a growth path if possible. It cannot be done in one year, it cannot be done in two years, but between 3-5 years that is what we want to do. So, what does de-volatize mean? The domestic truck and domestic bus business are very important to us and the domestic LCV business as well, very important, right because that is the bread and butter. But the one that keeps swinging the fortunes of the company is the domestic truck business. So, what we have decided consciously is that while we will

continue to invest and pursue to gain leadership in domestic truck business and when I say leadership, I mean not in terms of market share, that is an outcome but we want to be seen recognized as a very consistent and a dependable player by customers and setting best practices and best products in the country. So, while we continue to do that and pursue that leadership, okay and if the market share comes, we have gained 3.7% market share this quarter. It is come because our network is better. But anyway, coming back to this, so while we continue to do that we want to de-volatize the company from the truck business which means I have to grow all the other adjacent businesses which are the bus, the LCV business, the aftermarket revenue, the defense business and also the international business. So, we have set ourselves three levers or four levers. We want to grow our LCV business now disruptively; we want to grow our aftermarket revenues to about 15% of our revenues maybe 12% to 15% of our revenues. Today it is at about 4%-5% and it is highly profitable. The third thing that we want to do is we want to grow our defense business. You have heard our MD say anywhere to about a billion Dollars. But I would say that even if we have to get it to a range of about 2,500 to 4,000 crores that is a huge jump. But let's assume we are able to, we are targeting internally for that kind of a growth. I am not giving a forward-looking statement, mind you. I am trying to share with you what is happening in the company today. The first thing that we want to do is to grow the international revenues. Today I am at about 10% of revenues. Can I get this up to 25% of revenues? Can I get? And that is where some of our best brains are now housed, they are in the Middle East, they have got some of the best pool of talent there. We are looking at Africa as a main set of countries where we would want to grow our exports because the product fit is there. We have a reasonable cultural fit with the locals there. The second market that we would look at is the Far East and lastly maybe we will also look at the South America. So, our initiative is to do 2-3 things. I will continue to explore new markets and drive new products and new business, I mean expand non-truck businesses, like defense, LCV, international and bus business, so that they help to de-volatize. While I am doing this, I will drive operational efficiency within the company. We have already shared with you some of the initiatives that we have done in the past, which has helped us to actually kind of turn around the company very quickly. So, we will continue to work on our designs and material cost and ensure that and our expenditure and drive our operational efficiency upward. While we keep doing this we will also look at our manufacturing systems, we will have to see whether we can bring in modularity there to ensure that we reduce complexity in the way we are doing business. See there are 2-3 ways in which we want to drive the company forward and as we keep doing this rest assured that we will share both the wins and the losses with you, so that we get a fair understanding of what is happening in the company. So, the larger issue is of course, I mean there are huge amount of investments that the company is making not in terms of dollars, but in terms of efforts, in terms of automation and telematics and whole data mining and big data because we believe that that is where the future is. We will have to make investments into artificial intelligence; we will have to make investments at later point in time into deep learning technology, so that we are able to ensure that our truck starts becoming efficient in terms of technology adaptation. How do I get connect with the truck driver, how do I get connect with the mechanic, how do I connect myself with the fleet operators, these are the things that we are looking at and even as we are doing this we are also empowering our front-end teams, we have already restructured our company, we have split it, it was a single company which moved to six businesses, which are now made to broken down by zones. Now they have

been broken down into regions, each of these businesses is further getting broken down into sub-verticals. So, there is a whole bunch of stuff that we are doing today, which will make us more nimble footed and efficient as we move forward. But I just thought I will take this opportunity because this is not just about Euro III and Euro IV, this is not just about Euro VI. Of course, we have to be ready. We are one of the few manufacturers that are Euro VI ready predominantly. Okay? We have to do some work, but predominantly we are there. We have got an exhaust after-treatment system called Albonair, one of the 4 or 5 in the world and we need selective catalytic reduction for Euro VI as well. So, we have a whole bunch of roadmaps available and we are pursuing them, so that at the end of maybe 3 to 5 years, you will see a much more predictable company, which means stable earnings, stable ROC, stable debt/equities, stable cash flows. That is how we are working towards the company.

Raghu Nandan: Sir, on exports second quarter number, absolute number I had about 7 billion. Can you share the third quarter number?

Gopal Mahadevan: See, export volumes, export was 7 billion it was in Q3, was 388 crores.

Raghu Nandan: Any specific export market or anything which was there in 2Q, which did not come in 3Q because of ...

Gopal Mahadevan: Because in second quarter we had Senegal order, which was Africa order. This 3 that is why I said, we are trying to get stability into this. We have an order bank, let me assure you but the execution takes a little bit of time because there are contracts to be signed, there are Exim finances to be tied up. Even as I talk to you, I have got a reasonably healthy order book but I cannot execute till these things happen. So hopefully, you will see that happening in the fourth quarter and you must remember another thing. Our traditional market of Middle East did see a little bit of Sri Lanka and Middle East did see a little bit of dampening because of the situation in Saudi Arabia and the Middle East. Sri Lanka also has actually gone through certain amount of changes within the economy, but we are expecting that all of these things will start evening out as we move forward.

Raghu Nandan: And sir, on the domestic side would January sales are better than that of November and December? Are you seeing a gradual recovery happening post demonetization? When do you expect some amount of normalization?

Gopal Mahadevan: See, we are actually definitely seeing that you guys are more experts than us because we are actually utilizing one industry but the general feeling I get is that if the government keeps pumping more money into the economy, I believe that some 9 lakh crores has been pumped, that is what the statistic says. So, the situation at ease and they are going to remove the restriction on cash withdrawals is what they are saying. So once that happens I would say that there would be a certain amount of normalcy that will come in because especially for the trucking industry because a lot of it is done in cash not because it is unaccounted because most of the drivers' wages and fuel and toll payments, etc., happen only in cash. So, we are actually definitely seeing that situation is a lot more eased now. Certainly, physically you and I do not see any lengthy

queues in ATMs anymore. So we are seeing the situation change. But I think what is more important is that the general economic condition and the economy should start reviving. There should be a greater sense of confidence now that should come in. We are predominantly an insular economy. Our share of global exports is insignificant. There are so many things that we could do to fix ourselves and get up and run very quickly, faster than other Asian economies and hopefully we will see that happen. I mean, there is a lot of promise that India holds out and hopefully that will happen. If that happens, believe me commercial vehicle industry will do very well and if commercial industry does very well, Ashok Leyland will do even better. But if that basic foundation is not done, which is the economy growing then we have a larger challenge not only for commercial vehicle industry but for a whole bunch of industries.

Moderator: Thank you. We have the next question from the line of Basudev Banerjee from Antique Finance. Please go ahead.

Basudev Banerjee: Congrats for good set of numbers. Few questions. So one is what part of this raw material inflation has already been factored in your numbers because in historical quarters if one sees your RM-to-sales have been as high as 73%-74% also. So, now all the way from lows of 68 you are back to around 71. So how do you see this steel inflation and other raw material inflation impacting your gross margins especially in coming quarters?

Gopal Mahadevan: See, I will be very pragmatic. What I do not know, I will say I do not know, to the effect that I do not know to be honest. I will tell you we have done a correction of pricing for 4% in January-February. Hopefully, we will not give away all of it because at some point in time a certain amount is given away and a certain amount is retained. But what we are doing is we are not giving away by current prices, we have raised the prices. We want to be competitive in the market but we do not want to let money on the table. We are also continuously monitoring our raw material prices. So, we are negotiating, we are working with suppliers to kind of reduce the impact, so both. Now, what has happened in Q3 is that there has been a cost push and a realization reduction that both bottom-up and top-down has resulted in the margins getting impacted. Hopefully, I am confident at the moment, I can only exude confidence because we are just starting, right. We would see the negative of that happening also. That means possibly the realization should start becoming a little better and we will also see that the disruptive increase that has happened in cost will actually start thawing up. That steel prices will not keep multiplying at the same rate it has happened. If that happens, you will actually see that the profitability for the commercial vehicle sector will start growing. Having said that we are putting efforts, the team I have great respect for our marketing team, supply chain and our manufacturing teams and everyone, who are striving to see to it that we continue to maintain profitability. Believe me, it is extremely difficult. So, there are so many moving parts. I wanted to share that also because people say, you told 15%-20%. I told 15%-20% because in the previous financial year people used to say you are very conservative. I said I am not conservative, what I see I tell. So, when I saw 15%-20% growth I shared. Now, today I do not know, so I am telling you I do not know. But what are we doing? Are we doing our best? I believe so. We are really looking at our cost; we are looking at how I get my volumes up in the region. So we have grown in all regions. So, we are trying to improve the overall performance of

the company and that is exactly what I can tell you. So, to answer your question now specifically, I believe that the steel price increase hopefully will not be at the same level as it was in Q3. But we will have to wait and watch because if, for example, the coking coal prices go up, then again we will see a price increase and then again we will have to take up a price increase. Hopefully, the economy will start growing if that happens then we will have an opportunity to have another price increase. Quarter-on-quarter Ashok Leyland has been increasing prices.

Basudev Banerjee:

Assuming the commodity prices remaining the same as of end of Q3 is there still a scope of further raw mat basket moving up because in Q3 numbers it may not be reflecting the whole of the inflation as you must have used the cheaper commodity at the beginning of the quarter?

Gopal Mahadevan:

Well, I will only tell you one thing. There could be an impact of the entire raw mat basket coming in but we have also taken a price increase. So, I do not expect, if things remain the same as they are in Q3, I see that Q4 should be slightly better. What can queer the pitch can be my mix. See, I will tell you as a person of the management, while I am very concerned or very particular about profitability and EBITDA margins, what actually we do at Leyland is, we see whether individually each of the businesses are performing better or not. The sum-total of it might sometimes queer a little bit because of a mix. Like for example, say if I have had great export quarter in the fourth quarter, obviously my profitability will be better. But if I sell more ICVs, my profitability will be little lower because ICV, the higher the tonnage of the vehicle the more is the profit, right, the profitability. So what happens is, a lot of things depend on the mix as well. We will have to wait and watch for the mix which I cannot predict at the moment. The third moving part is that we have this Euro IV pre-buy. If that happens that will augur well for the company also. But overall, have I done the right things, am I keeping my cost intact? Yes. Has my debt level come down? Yes. Has my interest cost come down? Yes. Is my manpower cost reasonably intact? Yes. Have I gained market share in a tough quarter? Yes. Has my volume grown? Yes. Okay? Has my EBITDA grown? No. So everybody is looking at only that one word called 'EBITDA'. I am not finding fault. Yes, but that is only one of the matrices and that is because it would require a miracle to grow an EBITDA in this kind of a quarter where you are having a cost pressure because of raw material prices and you are having a realization pressure because of discounting. I hope I have been able to give a perspective to this.

Moderator:

Thank you. We have the next question from the line of Mukesh Saraf from Spark Capital. Please go ahead.

Mukesh Saraf:

Sir, firstly on the LCV business, there were some commentary that in the next 3-4 years you are looking at a significant growth in that business 2-3x kind of a number. So, just checking how are we looking at the new platforms that can come in further? Is there some kind of a royalty arrangement with Nissan or is it going to be completely in-house kind of new platforms?

Gopal Mahadevan:

Yes, at the moment I will not be able to share specific details about the platforms, etc. All I can tell you is that we would be making product introductions which will be maybe possibly extensions of the existing product but which will actually increase the ballot of vehicles that we have. So, the offerings that we will have, we will have more offerings at various price points and

various GVWs in the segment. See today, I think that Dost has been a fantastic product. It has changed the way LCV was determined in the country and it has been able to in its addressable space a single product has been holding on to 15% share in its addressable market. It outperforms competition on all critical parameters. So, I see the same thing happening as we move forward. So, when you have a larger set of offerings happening, we are actually going to see our share of business going up in the market. When that happens, the LCV business will start growing more profitable. Today, it is held between 3 companies and the main company and there is an arrangement all of which hopefully in the forthcoming year, we will be able to kind of simplify, weed out unnecessary cost. A lot of work that has happened in Ashok Leyland to help it turnaround is what is happening in the LCV business today.

Mukesh Saraf: But, there is no royalty kind of payment that you will have to do to ...

Gopal Mahadevan: Of course, we have a commercial arrangement, details of which I cannot share with you because we are bound by very strict confidentiality. But frankly, I do not think anything will set us back. So we have to look at the business as a whole.

Mukesh Saraf: And sir, my second question is the current inventory levels, how they will be at the dealer level? Is there some kind of an increase because you are, plant level I am sure there is some kind of an increase because we are seeing the production numbers versus your wholesale numbers. What would that be at dealer level, is there some kind of an increase there also?

Gopal Mahadevan: No, I do not think there is any concern on the dealer level inventory because we do not push inventory. We are keeping inventory. Our inventory levels have gone up in the 3rd quarter and that is planned, okay? It is not that, we have deliberately increased our inventory levels in the 3rd quarter, so that we do not miss an opportunity for a sale in the 4th quarter. The basic idea is very simple, old fashioned logic, pre-produce and keep a little bit of inventory because you expect a demand upsurge in the fourth quarter. In the event, God forbid the demand upsurge does not come then I start resizing my manufacturing in the month of February. That is the plan.

Mukesh Saraf: What would be the plant level inventory now sir, in just absolute numbers?

Gopal Mahadevan: The company level inventory of FG is about 11,500 vehicles or something like that.

Mukesh Saraf: This will all be the trucks, heavy trucks, M&HCVs?

Gopal Mahadevan: Predominantly. LCV will be very insignificant. So if you look at it, we have added about 4,000-5,000 units and it is a plan. But if you look at my OWC, my operating working capital is very much intact because I have been able to also reduce my receivables a bit and we have got some advances which has helped us and so my total borrowings at end of Q3 is only 1,520 crores. So, actually I have seen a positive cash flow coming in, in the third quarter. But see these are decisions. Some of the people who meet me they know that I never give an obtusely positive thing. I do not give an obtusely negative thing. But the decision on inventory was much planned. We decided to increase the inventory, so that we do not miss an opportunity because our

production loss is a permanent loss, we will never get it back. But you can always reduce the production in the future in the event it is not required. So, that is what we are planning we expect that the quarter should be good and then there will be a pre-buy. That is our expectation at the moment.

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

Kapil Singh: Sir just wanted to check on this raw material cost. We have seen a pretty sharp increase and I know you have already answered it in detail but just to get a breakdown in terms of when we have seen this 300-basis points kind of increase how much of it is due to raw materials and how much of it is due to higher discounting that we had to do which might recover later?

Gopal Mahadevan: See, while I cannot give the granular detail but let me tell you that if you look at the EBITDA margin impact I would say that they are reasonably split because the raw material price increases were predominantly on account of steel price increases. And if you look at the discounting that has happened and if I were to take a look at the numbers again the numbers add up to almost the same level of thing, the impact is almost the same. One maybe I can say it is 60:40 in favor of discounting and raw material if you want a more accurate number.

Kapil Singh: And sir, what percentage of our cost would be steel?

Gopal Mahadevan: Well, steel would account for I would say about 50% of our overall cost.

Kapil Singh: Out of 70%?

Gopal Mahadevan: It is not direct steel. Why I am thinking back at steel and associated metals are there, out of 70%, I am saying 50% of my overall material cost because I buy flats and then there are steel in various components and sub components.

Kapil Singh: So sir, out of this 70% how much is steel?

Gopal Mahadevan: I will have to get back to you because I do not want to give a wrong number I don't remember accurately because if you really ask me, I know that see the direct steel that we have constitutes about 40%-45%. But you see that there is steel that goes into cabins, there are steel, we have non-cabbed vehicles, right? We make in-house bodies, we do not make in-house bodies there are various grades of steel. Some have got increased some have not got increased. So, that is why I am humming and annoying. I have the number. But if I give you that if you do a math, it will not work out you see that is the problem. It is not saying that okay, so 60% of my raw material cost is steel, if I take that this is so many tonnes per vehicle and if I multiply will it add up? It will not add up because there are sub components in which I have not taken a price increase. There are sub components in which we have taken a price increase. So, it becomes very difficult to give that kind of a number.

Kapil Singh: So, maybe I can discuss this offline later with you.

Gopal Mahadevan: Yes.

Kapil Singh: What I am trying to say is that initially you mentioned that while Ashok Leyland has taken a 4% price hike some of the competition has not taken. So, the price hike is it getting effected in the market, are we getting higher realizations in January?

Gopal Mahadevan: You also heard me say that we have taken the highest price hike and what we have done is also hopefully, we will be able to retain a significant portion of it because see there is a pressure on pricing in the market. It is a huge decision; believe me to take this price hike because on one side, all of us want to know why our EBITDA margins cannot improve with operating leverage. On the other side, we also have to grapple with the situation where the market is actually tending to discount to catch customers. We do not do that predominantly. What have we done to grow this business? If you look at it over a five-year period, why is that that Ashok Leyland has gone from 25% to 34% market share? It is because of two, three things. It is actually one of the most important things is, it has actually increased its network disruptively over the past six years at least. The network has increased disruptively. The second thing is, it has also invested heavily into product quality. Not that the product quality was bad but it is actually going from good to great. We are ensuring that we are looking at the total performance, total cost of ownership for the customer. The third thing that we have been doing is, we have also ensured that the spares after-sales and after-sale service has stepped up dramatically. Fourth, of course, we have also been introducing products at various points in time repeatedly to fill slots. Discounting is a point of sale decision, which we leave it to the salespeople to decide. But we cannot say now, come on let us increase our discounting now we will start increasing our market share. We do not do business that way because each of our guys, including the regions and zones and each of the businesses, they want to look at a P&L which looks at operating working capital, it looks at market share and also it looks at EBITDA margin. So it is a pretty complex decision-making that happens. Of course, I mean, I would not be correct if I say I do not discount. Yes, we have to sometimes if the difference is so high, you have to match up at least part of it not if, so that the customer is convinced that you are interested in winning his order. So, one other competitor has possibly increased by 1.5% that is what I am told and one more has not even increased it. So, we continue to actually ensure that we try because we have been quarter-on-quarter increasing prices except in the November quarter.

Kapil Singh: So, of course, this is the highest price hike we have seen, right, but whether it is getting effected in the market that is what I was trying to understand?

Gopal Mahadevan: Yeah.

Kapil Singh: And sir, lastly just on the pre-buy are you seeing initial signs of that already?

Gopal Mahadevan: We are seeing some signs but the pre-buy is a little too early at the moment to immediately confirm. We will have to wait for February and March to be honest.

Kapil Singh: And is it not clear that the trucks produced in March can be sold in April and period beyond that are we still waiting for clarity on that?

Gopal Mahadevan: There is clarity awaited but we believe that logically it should be allowed because it is virtually impossible to stop both sales and production the same day. You can either stop production or you can stop sales. But if you are stopping sales, production should have stopped quite some time back.

Moderator: Thank you. We have the next question from the line of Pramod Kumar from Goldman Sachs Asset Management. Please go ahead.

Pramod Kumar: My question actually pertains to the CAPEX cycle, as in we are already talking about capacity utilization being fairly high for you at both M&HCV and LCVs, you have some really big plans in terms of tripling business, and the fact that there will be more products, which will have to be lined up for the LCVs. So how should one look at CAPEX beyond FY17 and also if you can help us what is the CAPEX number, what are you looking for FY17 now that we are done with three out of the four quarters?

Gopal Mahadevan: See, I think we had mentioned that overall CAPEX plus investment should not be more than about 500 crores. We should be very close to that in the current year because we are just looking at some residual CAPEX to be taken up whether we should take it in the new year or not. That is why I am just hesitating a bit. As far as the new years are concerned, see there are 2-3 things that we have do and I just thought I will take this opportunity again to share. We are methodically also taking a review of our investment that we have in various subsidiaries and if you notice we have taken impairments in the past of the construction equipment joint venture, we took a complete impairment of the light commercial vehicle company that we had as a joint venture and we have also taken marginal impairments a little earlier to that in the high pressure die casting joint venture, etc. Now, as we move forward we are taking a long and hard look of the options and opportunities that we have. For example, in a company like Optare and these things are taking up cash and we want to ensure that we take a firm decision on these companies. The management is evaluating various options and we possibly will come to some decision in the fourth quarter about how we want to carry on the business of say, for example a company like Optare. Now, having said that the reason I am saying this is these are companies in which there have been investments. As we then take some rational decisions either to carry on or to look at other options for these businesses, the overall investment may actually start to come off, if we take it in the medium-term will come off. We will have capacity addition that will be required in the medium term but all of this will be more balancing in nature than heavy, large investments to be made. We will make some investments in building bus bodies, in cabbing facilities, etc., which will be required by regulation as the regulation starts moving towards fully built buses and fully cabbed vehicles. So, that is another investment that will be done. We will of course, have over the medium-term again, I am talking about three to five year term, we will have to make some investments in Euro-VI engines, some of which the work has already by the way started more than couple of years back and we already have the Neptune engine in place. As we move forward as have greater visibility about sharing the CAPEX and investment plans possibly in the

month of March but I do not think it will be more than 500 crores to 750 crores per annum. And you must understand that while these investments happen, the larger goal that we are working on is it is not a fixed goal yet but I am just sharing a direction that we want to do. "Hey! Can we actually have a debt-to-EBITDA 1:1? Can we move towards that?" That means EBITDA has to grow, debt will be predetermined and we also grow our topline, so that we maintain a healthy EBITDA. Is it possible? It should be possible, but it will take some amount of work. So, we are kind of acutely aware that we do not want to get into the high level of borrowing that we did in the past. We want to ensure that we have capital allocation done for the various businesses and that these businesses start returning in the medium-term. But I cannot give you a number now because the CAPEX is just getting decided over in the next couple of months. So, then I will have greater clarity about how much of CAPEX will be there for the next year.

Pramod Kumar:

On a related note, so LCV we are not looking at a substantial CAPEX in that sense because the way you are talking not more than 700 crores roughly for FY18 and you will have few launches there in the LCV portfolio as well. So, even with the LCV expansion and the capacity expansion we are not looking at a big step-up in CAPEX actually as such, is that understanding right?

Gopal Mahadevan:

No, maybe your understanding is partially right. At the moment, I am saying that at the moment I do not look at more than 500 crores to 750 crores of CAPEX for the next year. We are looking at a long and hard look at the LCV business. But like I mentioned, I do not want to record any number because I know you folks are looking at it to build up some kind of a projection but I would be more comfortable sharing this number in the month of March, when we have kind of crystallized our thoughts, because there is so much that has been happening in the company over the last year that we also said, let us wait for the fourth quarter to make some decisions because we have just taken over the LCV business, right, so I could not have forecasted an LCV CAPEX plan immediately of one month of takeover of the company. So, our LCV team is working on that, I can only tell you one thing, you can be rest assured that whatever CAPEXes or investment that we make, we want to ensure that these are very pertinent and start generating returns in a 2 to 3 years' time and we are very focused on 2-3 things. One is the debt-to-equity or debt-to-EBITDA. The second one is ROC. The third one is net operating margin. So, we want to be sure that all these matrices do not deteriorate in the medium-term and that they should improve.

Pramod Kumar:

My second question pertains to the price hikes, Gopal. You have already taken a 4% price hike, the competition may not be following you and then there is a BS-IV cost inflation, which would be in the tune of 8% or so, including the air conditioning which is now being made mandatory. So, I am just wondering for FY18, is the fleet industry in such a healthy shape to absorb so many price hikes and what it can mean to the industry pricing environment and profitability therefore in FY18? How should one think about, because it is too much of in a short span of time such a dramatic price increase and given where we are on the utilization levels as a fleet industry and the economic recovery, would it be a bit too optimistic to expect that all of this will be passed on?

Gopal Mahadevan:

No, this is actually got nothing to do with optimism. It has got everything to do with pragmatism. In the sense, how much of raw material price increase can I keep absorbing because it is like the

scylla and the charybdis meaning having to choose between two evils. The point is, if our EBITDA margins goal people ask, I mean what are you doing about that? What can I do? A truck is a truck. I cannot take out too much of material out of it beyond a point. I am working on it but I can keep continuously working on it to have a cost improvement. So, what else can I do? I have to then raise prices because if the input prices go up, I have no other choice and that is what has happened to steel. Steel prices have gone up so significantly that one has to raise prices. Now, if competition does not raise prices, well, I am not able to comment on that because I know this is the price increase that has happened, so I must compliment my sales and marketing counterparts who have taken the decision to hike the prices because we have had discussions, what do we do? Now, we hope that the decision is right. We hope that we are able to pass on the price hike to the customer and not again pull back some of it. But the basic direction in which we want to go is this. I want to ensure that I pass on some with the raw material price increases to the customer. Otherwise we cannot do business efficiently. I cannot keep sucking in cost and absorbing cost and absorbing price hikes. Then my profit, my business profitability will be affected. Now, is that because coming out of a sense of optimism? No, the situation in this quarter is better than what it was in November, so we decided to take a price hike. We did not take a price hike in November or in the quarter ending December. So, we have had to take the call. Hopefully, our call is right.

Pramod Kumar:

And lastly on network, Gopal. Do we see further scope for expanding our network, especially in the Eastern and some part of the Northern markets?

Gopal Mahadevan:

As far as any aspect of business is concerned, sorry to pontificate but I strongly believe in the words of Albert Einstein "only be done better". So, we will continue to invest in our network. Our focus is not on just Ashok Leyland profitability. The first focus on profitability is the end customer profitability. Can he because of Ashok Leyland or an Ashok Leyland vehicle the wheels of the vehicle should not stop, which means, I have to ensure preventive maintenance, I have to ensure he does preventive maintenance, I have to ensure he brings the vehicle inside to the dealerships or to the service centers to ensure that the service is done in time. I have to ensure good reach of parts at reasonable prices. That is the first step. The second step is my dealers. I have to continuously work to ensure that our dealers are also becoming profitable. From that if I do focus on these two, I would be able to ensure that our company also turns profitable. We do of course, look at company matrices but we are also studying the matrices of our dealers and our customers. So, we are focusing on the end customer. Let me tell you that at Ashok Leyland today, all functions, including the function that I head, are all now looking at the customer. How do I reach the customer, how do I make my company touch the customer better, how do I get the total cost of ownership of the customer better, how do I increase the customer experience better, what can I do to make the customer, an Ashok Leyland customer better than competition customer? This is exactly what we are looking at. Why I am giving you these slightly more expanded thing is, of course, we will be investing in growing our network but then we cannot just say the Ashok Leyland cannot grow the network. It is our dealers who have to grow our network. It is our partners who have to grow our network and if they have to grow, they have to be incentivized to grow and the best incentive for growing anything is to ensure that it starts returning money for them, which is what exactly we are working on. So, if you look at it about 6-

7 years ago, possibly I do not have the statistics with me readily, we must have had about 250-300 points of presence. Today, as I talk to you, if I were to take my sales, service, spares and also LCV outlets together, we are at something like about 1,500. We are truly a Pan India company today. That is why I have grown in all the four regions today. Now, can I ensure a repeat performance next quarter? I have no idea. But the basic infrastructure is in place to ensure that we have a pretty stable operation on a pan-India basis. Yes, I will continue to grow on the East, I will continue to grow in the North and in the West and Central and possibly in the South also.

Moderator: Thank you. Ladies and gentlemen, due to time constraints that was our last question. I would now like to hand the conference over to Mr. Karthik Subramaniam for closing comments. Thank you and over to you, sir.

Karthik Subramaniam: Thanks, Aman. Thanks for the management team for taking out time for the call. On behalf of Edelweiss Securities, I thank you all for your active participation. Have a great day every one.

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

Moderator: Thank you very much member of the management. Ladies and gentlemen, on behalf of Edelweiss Securities Limited that concludes this conference. Thank you for joining us and you may now disconnect your lines.