Conference	37449325
Company	Ashok Leyland
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Operator:

Thank you for standing by and welcome to the Ashok Leyland Q2 FY2009 earning conference call.

At this time, all participants are in a listen-only mode. We will begin with the presentation followed by a question and answer session at which time if you wish to ask a question, please press *1 on your phone and wait for your name to be announced. Please be advised, this conference is being recorded.

I would like to hand the conference over to Mr. Govindarajan Chellappa, over to you sir.

Mr. Govindarajan Chellappa:

Good morning everybody.

On behalf of Credit Suisse, I welcome you all to this conference call of Ashok Leyland post the second quarter results.

With us representing Ashok Leyland, we have Mr. Sridharan (CFO) assisted by Mr. Ranganathan, Mr. Balaji and Mr. Shyam. Initially, we will have Mr. Sridharan giving his thoughts on the quarter and we will go on to Q&A session later.

Mr. Sridharan, over to you sir.

Mr. Sridharan:

Thank you Govind and good morning to all of you.

Let me quickly run through the industry outlook as well as the Leyland's performance and also move on to the margins and the financials, and then leave the floor open for your questions.

First and foremost, I must say that the industry has been registering growth over successive months. While it is true that the overall drop in the TIV compared to the previous year first half has been around say 19% or so, month after month whether it is April or May or June or July, month after month, the total industry volume has been significantly going up, so also Ashok Leyland's volume has also been going up month after month.

The second important factor is that in terms of uniqueness of the second quarter, the total industry volume almost increased by about 40% compared to the previous first quarter and it even surpassed the fourth quarter of the last financial year, which generally used to be a very high number, and for Leyland also the fourth quarter volumes as well as the first quarter volumes have surpassed, in fact the second quarter volume is almost double that of the first quarter volumes.

But in terms of the percentages and in terms of the comparison with the previous year first half, as all would appreciate that you know the downfall happened only in the second half of the previous year. The first half comparison always comes up with poorly in the current year with the volumes dropping, and we also having lost market share in the first quarter, I would say to be very precise, purely because of the cleaning up process that we took in the form of pipeline inventory to be liquidated because we wanted to introduce the cash and carry system, and I will talk about this cash and carry system and how it has benefited us as we move forward.

To come to the specifics on the pockets of the vehicle volume growth, the JNNURM supplies continue to be dominating the total demand requirement, though the actual delivery of that would be much less than what the order book position is, in fact Leyland could supply only about 700 vehicles against close to about 5600 vehicle volume order book that we have. Most of the balance would all get delivered in the third quarter and some of it will also spill over to the fourth quarter.

The second important characteristic of the truck industry outlook has been that on an average every segment, whether it is haulage or MAV or tractor trailer or tipper, registered a drop compared to the first half of the previous year, so also in the second quarter, but very importantly the drop has been very pronounced in the tipper segment where the volume dropped to be more than 50% compared to the previous year. The pockets where the drop has been very pronounced, it is in the South as well as in the Eastern sector where the drop has been more than 70%.

On the export side, the volume performance for Leyland has been not very encouraging purely because the expected revival to the extent that we had anticipated in Sri Lanka did not materialize, but that got offset very pleasantly by the growth happening in

Bangladesh market, and of course the Dubai market is yet to revive, because of which we dropped our export volumes by about 20% compared to the previous year first half.

If I move to the margins part of it, there has been significant improvement in the second quarter and also in the first half. More particularly, the margin improvement of about 10.5%, operating margin improvement, in the second quarter has been achieved primarily because of three reasons. One, of course the volumes have been better than the first quarter, but very importantly it has been aided by the pricing action of about 2% which we took on July 02, 2009, which of course got actualized only for the months of August and September, but that definitely had contributed to the improvement in the margins. More importantly, we also could secure what we have been mentioning to all of you that the material cost reductions; we succeeded in actualizing the material cost reductions. The cost increase that we had sanctioned in the previous financial year amounted to close to about Rs. 50,000 and we succeeded in getting all that Rs. 50,000 barring for about Rs. 4000 to 5000 to be realized, which we will also ink it in the first week of October and November. Very importantly, the material cost reduction has enabled us to improve our margins by at least 200 to 300 basis points.

The two other pockets of cost reductions has been, one in terms of the tight control on volume related cost, even though the volumes have doubled compared to the previous quarter, it is down by about 25% compared to the previous year second quarter, because of which we ensured that the variable overheads, the volume related overheads, whether it is the production overheads like the cutting tools or power or consumables or the marketing variable overheads, all have been put under tight control, which enabled us to realize something closure to about 35 crores of benefits for the first half, almost 20 crores for the second quarter alone.

The third factor, which is the cost control, is on the general administration overheads, which we have been sharing with you of how we are what we call as frugal living in Leyland, we say that you know all those measures that we introduced in the second half of the last financial year are continuing with vigor in the current year also. That has enabled us to register something closure to about 15 crores drop in the general administration overheads whether it is travel or repairs or advertisements or any other expenditure, and more importantly going forward we expect that this administration overhead capsule continue to be affected for the second half also. Of course, the second half already has the benefit of the lower operating cost, so I would not expect that you would see a significant improvement over the second half of the previous financial year, but certainly the current cost cutting measures will continue and these reductions will be actualized.

The next appoint is on the financing cost. You will find that the second quarter has significantly reduced the impact of interest charges financing part, that is primarily because of our ability to bring down our working capital by almost 50%, in fact against the 1550 crores in the June 2009 end we could bring down the working capital to around less than 900 crores by September end, which translated to a significant reduction in the working capital, which has been primarily aided by two factors. One, the cash and carry system, which I mentioned earlier, which we introduced in May, which also had the effect of lowering our invoiceable volumes during first quarter, but in the process we could actualize the benefit of avoiding non-performing inventory levels of the dealers and thereby hastening the cash cycle process for us. We also succeeded in reducing our other production inventory and the vehicle inventory also. In fact, compared to September 2008, where the vehicle inventory used to be above 12,000, we have now brought it down to below 6000. All these have enabled us to reduce our interest cost and I expect that this trend to continue for the second half also, though the actual activity levels will significantly go up; I will shortly come to what I see as the possible outlook for us for the second half.

Coming to the outlook, we expect the volume growth to happen significantly. We have on hand on the bus segment an order book position of something close to 5000 vehicle JNNURM. On top of this, we have also got another about 3500 vehicles of order book from the state transport undertaking. So, close to about 8500 vehicles of order book we have for supply to the state transport undertakings. On top of it, we expect the private passenger segment also to register significant growth, in fact that is one segment which has not been very much affected in the current first half when we compare it with the previous financial year, and we expect those volumes to grow in the second half.

Overall, we expect the truck and the bus segment to register more than 20% growth for the full year, which will translate to more than 65% growth in the second half, of course I must admit that this 65% is all more out of the base affect that the last year second half has been obvious low. You get numbers like 65%, but if you continue the current trend the run rate for Leyland itself will be anywhere between 6500 to 7000 in the next three months and moving forward to the last quarter, it will be run rate of almost 8000 vehicle per month.

So, the overall volume that Leyland is targeting for the current financial year is above 62,000 vehicles with a bit of a luck we should even cross 63,000, that includes of course an export where we are targeting to achieve about 7500 vehicles.

In the margin front, I must also add one other development that happened post the second quarter. On October 12, 2009, we took a pricing action of 1.5%, so cumulatively we have so far taken 3.5% pricing action, and of course the material cost reduction coupled with this pricing action should improve our margin and enable us to sustain over 10.5% that we achieved in the second quarter, but I must also hasten and that there are dark clouds on the metal cost front, particularly on the steel and rubber, where there are pressures coming up for cost increases. We need to really see how we face that and whether we should be in a position to pass on such increases through one more pricing action are not, we need to wait and watch. That's on the cost front.

On the margin front, I have already mentioned, we will continue our current trends of cost controls both on the production overheads and on the sales related overheads where our warranty cost has been significantly brought down by more than 30% drop in our warrantee cost, and more particularly the frugal living in the form of tightening the belts on other administration overheads like travel, advertisement, publicity, etc. all will continue.

On the other than vehicle business, we have had a good order book position that we have on the defense side. I must mention that the second quarter did not benefit by a higher volume, which could be one of the reasons why the average revenue realization is lower. We could sell only about 500 kits in the second quarter. So far we have done about closer to 1000 kits sale in the first half. Again, it is an order book for about 2600 kits, so another 1600 kits will be sold in the second half. It is on the defense. In addition to this, we are also targeting to sell about 500 or so fully built vehicles to the defense, mainly the Water Bowser that we have been supplying to them. This would continue in the second half.

On the taxation front, I must say that we have been very realistic in terms of assessing our deferred tax liability as well as our entitlement under the MAT regime, but going forward I would not be able to guarantee that this level of low tax incidence would continue for the second half also.

On the Indian side, we had a setback. We had to be contended with a 10% drop in the volumes primarily because of the off take on the telecom related gensets have significantly dropped by more than 15%, and luckily we could offset it with the engine supply for the genset application on the regular standby genset applications for the higher horsepower. That could register a marginal growth. Overall, we sold about 9700 engines in the first half as against 10,700 in the previous year's first half. Going forward, we do not expect growth in the engine segment compared to what we sold in the last year, may be we would be happy if we could target to achieve the last years' level.

On the export front, I had already highlighted that we should be targeting about 5000 vehicles in the second half, which will take our volumes above 7500 for the full year.

On the spare part side, again this has been a very good development, though in the first half we registered a drop of about 9% in the turnover, which stood at about 267 crores as against 293 crores in the previous year first half, we expect to end the full year with a

10% growth over the previous financial year. The turnover should cross about 700 crores for us.

On the manpower side, we are now working practically on all days, all the six days of the week all the plants are working. As I mentioned earlier, the run rate is around close to 7000 vehicles per month in the current quarter, the third quarter, and it will move up to 8000 to 8500 in the last quarter. Accordingly, we are also sprucing up our supply chain and also equipping our plants with casual labour wherever needed, so that we could scale up our production capacity accordingly. Install capacity of course is there for about 100,000 vehicles or about 8000 vehicles per month.

On the settlements with the workers, we have concluded settlements with the workers in our Hosur – I factory. The settlements with the other units would follow. We do not expect major impact on account of these settlements, which have already continuously been provided for in the first quarter as well as in the last year's fourth quarter. It is many of the settlements are due earlier, and correspondingly the provisioning has been made for such likely increases also.

Moving on to the capital expenditure investments and the funding plan, we continue to maintain our projection of about 2000 crores for this year and the next two financial years, we will live within that 2000 crores, which is primarily to be spent for the capacity build up for Uttarakhand plant, which incidentally I must say would get commissioned by mid of January and we targeting to produce about 2000 vehicles between January, February, and March, which will be scaled up to 30,000 may be in the next year, and to the full capacity in the year following that. In other words, we are going full blast in our plans to commission the Uttarakhand plant, so the capex will be mainly for that and also for the two major product improvements; one, the Neptune engine for which we are putting up the facilities for manufacturing. We have successfully developed it and tested it, and now it should be put into various applications. And, also the next generation cab, which is nearing the developmental phase and should now get production as the drawings firmed up. The major investments will be for these two facilities apart from of course the product development related work connected with the emission standard changes, almost close to about 150 models are getting changed and need to be homologated with ARA approval in the coming year will be Euro 2 to Euro 3 emission change within all probability will get implanted. We also expect that the survival space and other safety measures that are being prescribed for a factory built cab would necessitate an early usage of the Williams fitted manufactured fitted cabs, which would enable us to utilize our facility for this next generation cab that we are putting in.

In terms of our funding plan, with the increased activity, increased internal accruals happening, we do expect that we should be able to meet the capex requirement with the internal accruals and with a moderate dose of borrowing without aggravating our debt equity beyond 1:1 level, and in our view this is quite possible given the increased internal accruals that are likely particularly with the Uttarakhand plant getting commissioned in January 2010, and there is every possibility that Uttarakhand plant's benefits will significantly go up once the excise duty rates gets increased and we have been hearing the Finance Minister saying that he will hold on to this stimulus package till March, which means that in every possibility that would be an increase in the excise duty rates for the coming financial year.

On the working capital front, we hope that we will further reduce from the current levels of 900 cores by another 200 crores. In other words, this also will facilitate our borrowing levels to significantly get reduced and we maintain our lean working capital levels by policy of cash and carry. We will continue with that policy.

On the various joint ventures that we have been going through, we believe that the understanding that we have reached with Nissan Motors that both the parties could utilize their existing facilities, which will be available to them at least for next few years, so that a green field type investment is avoided. That would enable us to utilize our existing facilities much better, so we do not see it is a major issue when Uttarakhand capacity gets added. We do not see a major issue because the LCV plant, the products will get introduced by 2011, and by which the next two years we should be able to utilize the existing capacity for the cab paint and the cab welding with our facilities in Hosur and Uttarakhand.

On the other JVs, of course the John Deere is progressing well. We expect that the land will get acquired in the next few months and the product introductions will get firmed up once the capex plan and the levels of integrations are decided.

All other JVs are working and progressing very well. I must say that Hinduja Leyland Finance, the captive finance arm which we are planning to start, is yet to get the RBI approval, there are some delays experienced in this. We expect that these things should be overcome and in the next few months we should start our activity levels rolling up and increasing the branch network etc. for Leyland Finance in the next few months.

This is in short the overall position both on the Leyland side as well as on the investment side. Now I would request you to shoot your questions.

Mr. Govindarajan Chellappa:

Yeah. Thanks Mr. Sridharan.

Kitty, can we go onto the Q&A session please?

Operator:

Sure sir.

At this time, if you wish to ask a question, please press *1 on your phone and wait for your name to be announced. If you wish to cancel your request, please press hash or the pound key.

First on line, we have Mr. Kapil Singh from Nomura, please go ahead.

Mr. Kapil Singh:

Good morning sir.

Mr. Sridharan:

Good morning.

Mr. Kapil Singh:

What is the kind of increase that you expect in steel and rubber prices in second half?

Mr. Sridharan:

The rubber prices alone?

Mr. Kapil Singh:

Steel and rubber, both.

Mr. Sridharan:

Steel and rubber prices we do experience something like 10% increase, which would translate to something like Rs. 2 to 3 type of a per kg increase, but we do not expect this to get pressed in before the next couple of months. We hope to defer those actual implementation of such increases by at least two to three months.

Mr. Kapil Singh:

Right, and secondly, could you give me the engine revenue for the quarter?

Mr. Sridharan:

Sorry?

Mr. Kapil Singh:

The engine revenue for the quarter.

Mr. Sridharan:

We do not have the engine revenue readily available. I can give it to you offline Kapil.

Mr. Kapil Singh:

Okay sir. No problem. Can you also let me know what is the Capex in first half and the cash and debt levels?

Mr. Sridharan:

Sorry, your voice is breaking. Can you please say it again?

Mr. Kapil Singh:

What is the Capex in first half and what are the cash and debt levels?

Mr. Sridharan:

The Capex in the first half has been around 350 crores.

Operator:

Mr. Kapil, have you done with your questions?

Mr. Kapil Singh:

I also wanted to know the cash and debt levels?

Mr. Sridharan:

The debt levels are around 1900 crores.

Mr. Kapil Singh:

Okay. This includes the working capital loans also?

Mr. Sridharan:

Yeah, that is right; all the cash credits and everything, the total debt.

Mr. Kapil Singh:

All right. Thank you. Thanks a lot.

Mr. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line, we have Anosh Koppikar from Morgan Stanley, please go ahead.

Mr. Anosh Koppikar:

Yeah. Hi. Good morning. I just wanted to get a sense of what is the number of spare part sales you mentioned sir in this first half and second quarter?

Mr. Sridharan:

Second quarter was 145 crores and first half was 267 crores.

Mr. Anosh Koppikar:

And you are saying about 700 crores for the entire year, right?
Mr. Sridharan:

That's right.

Mr. Anosh Koppikar:

Okay sir. That's all. Thank you.

Operator:

Thank you sir.

Next on line, we have Hitesh Goyal from Reliance Equities, please go ahead.

Mr. Hitesh, are you there?

Mr. Hitesh Goyal:

Hello.

Mr. Sridharan:

Hello.

Mr. Hitesh Goyal:

Yeah. Good morning sir.

Mr. Sridharan:

Good morning.

Mr. Hitesh Goyal:

I just wanted to get a sense that in second half you are saying your volumes will increase quite rapidly, so just wanted to get your sense on the South market. Basically, where are you seeing this traction coming along in exports and you know which all industries and which segments do you think should pick up like tractor trailers, tipper should pickup or not, or it is only driven by haulage segment.

Mr. Sridharan:

At the moment, I must say the first half and more particularly the second quarter, the growth came from the haulage segment, and month after month there has been a significant increase happening in the MAV and tractor trailers. The pocket which did not experience not only for Ashok Leyland but for the industry also is the tipper segment, which did not grow, and we expect that this tipper segment will revive hopefully with the commodity prices firming up both in the Eastern side as well as in the Southern side. The drop has been more pronounced in the South and Eastern side as I mentioned earlier. I foresee an increase happening on the MAV this side significantly, you know, I am going by one important indicator. We were first to introduce this 8x2 three rear axle and one front axle type to carry about 30 tons plus. That vehicle has been a grand success particularly in the Andhra market, and we expect that the tractor trailer and the multi axle vehicles' demand will significantly go up in the second half. On top of it, we also have the order book position available on the passenger side, almost closed about 9000 vehicles on STU segment alone. On top of it, we also will have the private sector passenger demand coming up.

On the whole, the expectation is that on the domestic front, we should at least do something closer to about I would say 35,000 to 36,000 vehicles, which will take the total domestic output sale to about 58,000. On top of it, we have the export volumes of about 7000 coming up. That is the reason why we said overall I am very bullish in our possibility of exceeding 62,000 to 63,000 vehicle volume.

Mr. Hitesh Goyal:

Okay. Sir just one more question. Just wanted to get your sense on what is the state of the port activity in South, I mean is it picking up in terms of exports and imports?

Mr. Sridharan:

I do not have the numbers, but I would presume that it has not picked up in the first and the second quarter. We expect that hopefully should happen now.

Mr. Hitesh Goyal:

Okay sir. Thank you very much.

Operator:

Thank you sir.

Next on line, we have Mr. Pramod Kumar from BNK Securities, please go ahead.

Mr. Pramod Kumar:

Yeah. Good morning sir. Sir, I had a couple of questions on our Uttarakhand plant. Sir, you said you are targeting a volume of 30,000 from this plant next year, so what could be the kind of localization levels with which we will be starting this operation sir?

Mr. Sridharan:

The localization levels I would not be able to put a percentage number or anything like that. All I can say is that against the even at the current level of about say 8% excise duty benefit, we should get at least about Rs. 60,000 benefit. In other words, there could be a leakage or something closer to about Rs. 20,000. Even if the rate were to go up, obviously will change.

Mr. Pramod Kumar:

Okay, but we will continue to get the engines and engine blocks everything largely from the Ennore facility, right?

Mr. K. Sridharan:

No, the engine, machining, gearbox assembly, etc., will all happen within our factory premises in Uttarakhand and we also hope to get some forgings and castings from Himachal, which is also exempted. So, I would say it is a mixed bag, I mean that is the reason why I said, it is very difficult for me to say everything will come only from our Ennore factory or from our Hinduja foundry or anything like that. It could be a sourcing happening locally there also.

Mr. Pramod Kumar:

But you expect a minimum benefit of around 60,000 per vehicle for this 30,000 unit?

Mr. K. Sridharan:

That is right.

Mr. Pramod Kumar:

Okay. And sir, the second question I had was on the shift to Euro-IV Sir, what is the kind of investments which have gone into making Ashok Leyland compliant with Euro-IV emission norms; I mean in terms both the engine transmission everything included?

Mr. K. Sridharan:

Our investment is more in the form of the changes that we make, whether it is electronics that get in or the FIP that gets changed, etc. Not so much with the capital investment, of course capital investment is there not only just for a one emission level change, like our Neptune engine which caters to Euro-III, Euro-IV as well as Euro-V. Obviously, that on a standalone basis will call for at least 300 to 400 crores of investment. The emission standard change that we are targeting, incidentally we do not have to worry about Euro-IV because hardly any vehicle would get, the number of vehicles that will get sold on the higher end of the emission standard will be very minimal for a commercial vehicle. For example, the Euro-III vehicles sale will be less than 1000 for Ashok Leyland for the whole year, because 90% of the guys will all operate from outside the designated cities, whereby registering their vehicles which need to comply only with Euro-II. So, we need to worry about Euro-II versus Euro-III, these are the major one, and that in terms of the investment for the customer that will be somewhere closer to about Rs. 40,000 per vehicle, which in our view could also be causing some amount of traction into this current financial year. Some sales of April and May could flow into the current financial year also; I mean I must add that as another factor that can also contribute to a significant increase in the volumes in the last quarter of the current financial year.

Mr. Pramod Kumar:

Okay. And sir, as you said Uttarakhand will be doing 30,000 next year, so that means, and I think the growth which we are expecting in FY11 may not exactly be 30,000 for Leyland in absolute volumes. So, are we looking at some kind of a manpower rationalization down South in our plants?

Mr. K. Sridharan:

Definitely, we will be rationalizing our utilization levels in the other plants. As I mentioned, you know, there will be quite a bit of an activity build up for our LCV manufacture in the down South plants also for launching the vehicles in 2011.

Mr. Pramod Kumar:

If you can just qualify that statement whether it is going to be . . .

Mr. K. Sridharan:

No, the target is about 70,000 vehicles to be done, but then obviously in the first year it will not be of the order of about 70,000. Certainly, this 30,000 vehicles in Uttarakhand plant would mean some lower levels of production in the other plants of Ashok Leyland, like Alwar plant or Hosur-II plant where the casual labor is more, in fact we are adding about 1000 casual labor now for catching a bit of our production for the fourth quarter, that would obviously get knocked off if the Uttarakhand plant can take that load.

Mr. Pramod Kumar:

Okay, and sir are there any penalty clauses in the supplies to JNNURM for if there is any possible delay from Leyland side, because we did hear about some SUs saying that they will be eligible to get penalties from the companies be it Ashok Leyland or Tata Motors on every day of delay in delivery.

Mr. K. Sridharan:

Yes, there are penalties there, but it will be too premature for me to now talk about any such thing because there are quite a lot of issues to be considered gone into as to say when that penalty can start. In terms of changing the specifications, etc., etc., all needs to be factored in before we come to one conclusion to say that, yes the supplier is liable for this delay liquidated damages or penalties.

Mr. Pramod Kumar:

So, we do not expect Leyland paying any penalties rather.

Mr. K. Sridharan:

Hopefully, yes.

Mr. Pramod Kumar:

Okay, sir. Thanks a lot and best of luck for the future.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line we have from Mr. Sharad from BNK Securities. Please go ahead.

Mr. Sharad:

Sir, my questions have been answered. Thanks a lot.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line we have Mr. Sahil from Enam Securities. Please go ahead.

Mr. Sahil:

Sir, thank you for the call. Just a question. If you can throw some color on the performance of our AVIA venture for the quarter and a half please?

Mr. K. Sridharan:

I mean I do not have the numbers for the quarter, but I have the numbers for the cumulative for the nine months ending 30th September, is about 600 vehicles, and it is cash breaking even. We hope going forward the unit to be making profits. We have done two major cost reduction exercises primarily on the press tools where we have inverted the press tools and then supply the pressed components from here. And second we have also quite successfully ensured that the gearbox will be supplied from Leyland for fitment into those vehicles. With these two major improvements, we have achieved a significant cost reduction which enables the cash breaking even. We need to now watch and see how the volumes pick up there. They have been affected by the downturn particularly the last October onwards and Europe is yet to get out of it and because of this the volumes have not picked up.

Mr. Sahil:

All right, sir. Thank you so much.

Operator:

Thank you sir.

Next in line we have from Mr. Chirag Shah from MK Global. Please go ahead.

Mr. Chirag Shah:

Hi, good morning sir.

Mr. K. Sridharan:

Good morning.

Mr. Chirag Shah:

Sir, congrats for a good set of numbers.

Mr. K. Sridharan:

Thank you.

Mr. Chirag Shah:

Sir, some basic questions first. Can you just help us understand what would be the gross block addition that would have been because of Uttarakhand, because you would be capitalizing it in fourth quarter of FY10, right?

Mr. K. Sridharan:

That is close to 1000 crores.

Mr. Chirag Shah:

1000 crores. And next year incremental addition that would have been would be how much?

Mr. K. Sridharan:

Hardly anything.

Mr. Chirag Shah:

Hardly. So, 1000 crores would cover almost the entire . . .

Mr. K. Sridharan:

No, 1200 crores is the total, and 200 crores would be on the land itself, so the depreciable assets would be around 1000 crores.

Mr. Chirag Shah:

Okay. And second thing was that sir your depreciation policy is you charge depreciation for six months, right, or is it quarterly based?

Mr. K. Sridharan:

We charge depreciation based on the actual number of shifts that particular plant works. For example during the periods of October to March last year or for that matter the first quarter of the current financial year, because we worked only for select days in a week, we charge only one single shift depreciation, but once we move to a full work which happened from August onwards, we charge depreciation on a full basis, two shifts, multiple shift basis.

Mr. Chirag Shah:

Okay. And sir, second just trying to understand, you have done a good work on reducing your costs, both fixed as well as variable. What is the incremental addition or in break even levels do you see with commissioning of Uttarakhand project, because it will be having excess activity?

Mr. K. Sridharan:
Uttarkhand in terms of the operating costs for this current financial year will not be very significant, in fact it will be even less than about say 7 or 8 crores of rupees in the form of administration overheads and other fixed expenses. Going forward, in fact that plant has been so designed that it is supposed to operate on a lean concept right from in warding onwards. In fact, by way of a design we have planned it in such a way that there is no storage space there. Nobody will be permitted to store the material and it will all be on a just in time basis, and luckily many of the suppliers and other supply systems are so designed that you know they will be able to get their material as needed for that shift right at the assembly line itself or the shop floor line itself. So, taking all these aspects into account, this particular plant additional cost in my view is not likely to be significant, but even on a very conservative estimate, if I take it, it cannot be anything more than 20 to 25 crores for the full year, and from that point of view the break even levels could go up by 25 crores or so.

Mr. Chirag Shah:

Okay. Sir, and last thing was, I am just trying to understand your logic of creating this new finance subsidiary. You already had a financing arm which you merged some years back, some time back, now you are re-bringing that concept again as a subsidiary. What was the thought process behind this from the group perspective? You could also have gone for an associate kind of expanse in there?

Mr. K. Sridharan:

Let me clarify two things. First, earlier Ashok Leyland Finance getting merged with IndusInd Bank, was done primarily to ensure that the financing arm has an access to cost effective source of funding. All of us will have to admit that a bank has got a better edge compared to NBFC when it comes to the cost effective source of funding, whether it is savings bank account or the current account balances which can bring down the overall cost of borrowing for a bank. In terms of the need now for starting a finance company, we realize that IndusInd Bank as a commercial bank cannot just only finance Ashok Leyland vehicles. It is also financing quite a lot of competition vehicles, quite a lot of other vehicle segments like the smaller Ace or cars, etc., etc. So, we really want to have a focused attention to be given to pockets where we need that financing support because of which we now want to start this dedicated captive financing arm. And this financing arm, in terms of its structure is not likely to be a 100% subsidiary because we are also having plans to induct strategic partners in this thought and we may retain only some significant equity levels to control and ensure that it caters only to commercial vehicle sales of Ashok Leyland.

Mr. Chirag Shah:

Then it will be a subsidiary, it will not be an associate, right?

Mr. K. Sridharan:

It will be an associate; it will not be a subsidiary.

Mr. Chirag Shah:

Okay, fair enough. That is the point I wanted to understand. Sir, one more question. Can you just share what was the defense and spare parts sales for this quarter?

Mr. K. Sridharan:

The defense as I mentioned, we sold about 500 kits in the second quarter and the spare parts we sold about 145 crores.

Mr. Chirag Shah:

145 crores. And any fund raising activity plans, any thought process on that?

Mr. K. Sridharan:

We need to really raise funds to meet our Capex, the balance Capex, that would be needed for the current financial year, another about 400 to 500 crores to be raised for funding it, of course few hundred also would be needed for investments in the other ventures that we are doing, but that all would hopefully get met through the increased accruals that we are now likely to get with our volumes going up. So, we need to raise about 400 to 500 crores, which we will do either through term loan or we are also contemplating and discussing whether any equity form of an infusion could be done.

Mr. Chirag Shah:

But sir, by what time can we expect any final process on this, in the next six months, can we expect anything happening in the next three months or timeline or it is not yet decided?

Mr. K. Sridharan:

Not yet decided. It will not happen before the next two months, I must say that.

Mr. Chirag Shah:

Okay, sir. Thank you. Thank you very much, sir.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.
Next in line we have Mr. Amar Mourya from BOE Research. Please go ahead.
Mr. Amar Mourya:

Hello sir. Sir, I just wanted to know about what is the number of vehicles you are targeting for second half?

Mr. K. Sridharan:

You have to deduct from 62,000-63,000 the first half of about 22,000 vehicles; so, about 40,000.

Mr. Amar Mourya:

40,000 vehicles.

Mr. K. Sridharan:

40,000 - 42,000 vehicles.

Mr. Amar Mourya:

Thanks a lot. Thank you.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line we have a Ms. Vyshali from Angel Broking. Please go ahead.

Ms. Vyshali:

Thanks. My questions have been answered.

Operator:

Okay. Thank you madam.

Next in line we have Mr. Dipen from Enam Asset Management. Please go ahead.

Mr. Dipen:
Hello sir. I just wanted to understand you know looking at the rapid recovery in the second half and overall economic revival that we have been seeing, when do you see the overall volumes in the industry going back to the FY08 levels?

Mr. K. Sridharan:

The next financial year.

Mr. Dipen:

We should be ending FY11 at the similar level of volumes?

Mr. K. Sridharan:

Yes, hopefully.

Mr. Dipen:

Okay. And sir, just one more thing, just was wondering if you can share with us, what is the EBITDA margin you get in engine and spare part revenues?

Mr. K. Sridharan:

We do not share that margin levels, but definitely the spare parts is much better than the vehicle and engine is much lower than the vehicle.

Mr. Dipen:

Okay. And sir, you said that gross debt is about 1900 crores, right, at the moment?

Mr. K. Sridharan:

That is right.

Mr. Dipen:

So, the weighted average cost would be how much, approximately, interest cost?

Mr. K. Sridharan:

The working capital funds in that are almost closer to about 400 crores or so, which carry an interest of less than 5%. The foreign currency funds are around less than 6%. There is only about 150 to 200 crores of a rupee debt which could be carrying around 9% to 10%.

Mr. Dipen:

Okay. And sir the foreign currency borrowing will be how much of 1900 crores?

Mr. K. Sridharan:

It will be about less than $300 million.

Mr. Dipen:

Less than $300 million. All right, thanks a lot sir.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line we have a Mr. Jamshed from Citi Group. Please go ahead.

Mr. Jamshed:

Hi sir. Thanks for taking my question. On the Uttaranchal facility what sort of vehicles will you be looking to produce sir, the higher tonnages or lower tonnages and it will be 30,000 on a total capacity or 50,000. Is that right?

Mr. K. Sridharan:

That is right, for the next financial year. The focus will be on maximum value addition, which by that definition will mean the higher end vehicles, the trucker trailers, and multi axle vehicles will be the top priority there, and in all that we will also be focusing on a fully built solution rather than offering in chassis form, in other words we will offer with the driver cabin you know fully built vehicle form.

Mr. Jamshed:

Okay. And you said the savings per vehicle out there will be about 60,000 bucks.

Mr. K. Sridharan:

Conservatively, I am putting it that way. On 8% on a 15 lakh vehicle will be more than 1,20,000, but I took on an average about 10 lakh per vehicle and then took 8% as 80,000 minus 20,000 rupees of leakage due to inputs coming from outside. The minimum revenue benefit we should get is about 60,000.

Mr. Jamshed:

And that is a tax free facility also, right?

Mr. K. Sridharan:

Yes, income tax is on top of this.

Mr. Jamshed:

Okay, sir. Thank you so much.

Operator:

Thank you sir.

Next in line we have Mr. Alok Rawath from CLSA India. Please go ahead.

Mr. Alok Rawath:

Good morning sir. Congrats for the good quarter.

Mr. K. Sridharan:

Thank you.

Mr. Alok Rawath:

Sir, a couple of questions. One, should we expect the interest cost to go up 4Q FY10 onwards once you start capitalizing the Uttarakhand plant, and if yes, then what would be the range?

Mr. K. Sridharan:

Yes, it will go up, interest cost has to go up because of you know as I have said 400 to 500 crores may have to be raised by way of debt. So, hopefully we should get it all below 10% interest. And our working capital levels should hopefully be again contained at the current thing subject to the market rates demanding; say our incremental interest cost will only be because of these 400 to 500 crores of our additional one. And that will all start also getting charged once the Uttarakhand plant gets commissioned in January. So, the fourth quarter interest cost would go up, but I do not expect a significant amount to be knocked off on account of the interest capitalization barring for this Uttarakhand plant commissioning.

Mr. Alok Rawath:

Okay. And sir, other question is regarding your LCV joint venture with Nissan. What would the nature of sales, I mean Ashok Leyland or Nissan will manufacture the vehicles in their own facilities and then sell to joint venture which will market and distribute it, or is there some other structure?

Mr. K. Sridharan:

Yes, that is the structure. You know, we will do contract manufacturing and give it to joint venture.

Mr. Alok Rawath:

Correct, sir. And sir, any sense of what kind of margins one would get on contract manufacturing?

Mr. K. Sridharan:

It will not be definitely the vehicle margin levels, but definitely we will get some contribution to meet our costs.

Mr. Alok Rawath:

Okay, so one should not expect too much of incremental contribution from there.

Mr. K. Sridharan:

Yes, but definitely it will mitigate our fixed overheads.

Mr. Alok Rawath:

Okay, understood. And sir, thirdly, what was the vehicle inventory at the end of second quarter and also if you could give me the number as of first quarter end?

Mr. K. Sridharan:

The vehicle inventory at the end of second quarter is 5900, and the vehicle inventory at the end of first quarter was 6348.

Mr. Alok Rawath:

I am sorry, come again sir.

Mr. K. Sridharan:

The first quarter end was 6348.

Mr. Alok Rawath:

Okay. And sir, last question; what would be your estimate for FY11 industry growth?

Mr. K. Sridharan:

In my view, if I go by the past trends and the past way in which the industry cycle reverses, the growth should be not less than 25% for 2010-11.

Mr. Alok Rawath:

25%.

Mr. K. Sridharan:

Not less than 25%.

Mr. Alok Rawath:

That is both in passenger and goods segment?

Mr. K. Sridharan:

Yeah, put together.

Mr. Alok Rawath:

Okay. Thank you sir.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line we have Mr. Bharath from Asit Mehta. Please go ahead.

Mr. Bharath:

My questions have been answered. Thank you.

Operator:

Okay sir, thank you.

Next in line we have Mr. Kunal from Dalal & Brocha. Please go ahead.

Mr. Kunal:

Yes, sir. Thanks for taking my question. It is just an extension on the previous question. I just wanted your view of the sustainability in demand after FY10 as in we are expecting excise duty benefits to go. So, what factors economically you feel that would sustain growth going forward?

Mr. K. Sridharan:

Fundamentally, the economic growth outlook, if you believe in the India story that you know the 6% GDP growth will translate to 7.5% or 8% going forward in the next financial year, that is going to be one major input. Second, of course, I very firmly believe and I am a strong believer in this NHAI projects and luckily the minister is also very charged in ensuring that you know the programs go on stream, and with some tweaking of the rules in terms of the incentive for the operators, we would expect the PPP projects, private public partnership projects, on road building to pick up tempo in the coming months. Last but not least, the freight rates have fairly now started firming up, and the viability of the operator is fairly in good shape. So, at least for the next say one year to one and half years' timeframe, I would expect that the sentiments to remain positive that you know people can expect better utilization of their vehicles if they buy it and put it on the road and I would also believe that the viability of the operator will remain fairly good hoping that the oil prices will not again flare up beyond the current levels of around say 70 or 80 dollars per barrel.

Last but not least, very important, a blessing in disguise I would say that happened in the last crisis has been the willingness of the public sector banks to open up the gates for refinancing the vehicle portfolio of NBFCs. In the past they never used to touch the NBFCs, not provide any funding to them. Now, this has been significantly now that this stimulus package by whatever name you call it has enabled the public sector banks to take a very positive approach to that. It is one of the reasons why the fund availability wise in terms of the commercial vehicle operation is fairly in very good shape and because of which the interest rates have remained steady. I would not say that it has come down nor it has gone up, it has remained steady, and so all these will point it to an optimistic positive approach which will translate to buying more vehicles.

Last but not least will be the revival happening in the world economy and consequently the increase in the exports side. From Ashok Leyland's point of view, we would expect some order of magnitude growth happening for three reasons: #1, the Uttarakhand plant coming up in a very integrated form and a state of art which seem to offer the latest vehicles, that is one. We are targeting to introduce about four or five new models with the introduction of our Neptune engine and the next generation cab. Both of these should make a dent in the domestic market. The last with the same reason of the Neptune engine availability which incidentally straddles horsepower range anywhere between 150 horsepower to 350 to 360 horsepower, that Neptune engine fitment with the next generation cab availability should make our exports very attractive. We have never been significantly present in the truck segment on the export side and I would expect that will be a phenomenal growth potential for Leyland. So, factoring all this, in fact one of the estimates that we did internally is to say that in the next three years we should be able to use the 150,000 vehicle capacity because of these reasons.

Mr. Kunal:

And sir with your financing arm coming up, what percentage of your vehicles would be financed out of that?

Mr. K. Sridharan:

We are not targeting that this arm will finance anything more than 10% of our vehicle sales.

Mr. Kunal:

Okay, sir. Thank you so much for your views. Thank you so much.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line we have Mr. Aditya from J.P. Morgan. Please go ahead.

Mr. Aditya:

Yes, hi sir.

Mr. K. Sridharan:

Hi, Aditya.

Mr. K. Sridharan:

Sir, congrats on a great set of numbers.

Mr. K. Sridharan:

Thank you.

Mr. Aditya:
I just wanted to understand your sense; I mean we have lost some market share on the passenger bus side. I can understand that there has been a delay in JNNURM but you know the competitors have gained. So, I was just wondering what is happening on that front?

Mr. K. Sridharan:

Truly, you are very right. We have lost market share in the passenger segment, but if you dig deeper into it, we have actually gained market share in the private sector passenger segment, which is, I would say relatively better in terms of the margins and profits than the public sector or the STU segment. But going forward, with the order book position of close to about 8500 vehicles or so, 5000 into the JNNURM and 3500 under the other than JNNURM for supplies to the State transport undertakings. We do not have any concern in getting back to our 48 or closer to 50% market share in the passenger segment.

Mr. Aditya:

Okay, and just currently on the passenger on the STU side, is it that the competition has gained a share of that or . . .

Mr. K. Sridharan:

Yes, we have lost market share on the STU passenger segment, which is one of the reasons why our market share has come down to around 40% to 45%.

Mr. Aditya:

Okay, sir. Thanks a lot.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line, we have Mr. Mahantesh from Centrum. Please go ahead.

Mr. Mahantesh:

Good afternoon sir.

Mr. K. Sridharan:

Good afternoon Mahantesh.

Mr. Mahantesh:

Sir, very good numbers and I am very happy that the recovery is on now in Ashok Leyland.

Mr. K. Sridharan:

Thank you.

Mr. Mahantesh:

Sir, my question relates to your working capital. You gave figures that said that you have managed very well your working capital and brought it down to about 900 crores. I am just wondering if I do a quick calculation in second half, you will be actually supplying a lot of JNNURM buses, you will have significant exports and you will have a small jump in your defense supplies, all of which if I understand entail a lot of credit to be given to the end customers. So, if I look at your second half volume guidance which is 40,000 to 42,000 vehicles, you should be doing the turnover of around 5000 crores. Nearly 20% of those 5000 crores is going to be for these set of vehicles, JNNURM buses, STU buses also you mentioned, exports, and some defense supplies. Should not your receivables go up because of this and hence your working capital need should go actually higher?

Mr. K. Sridharan:

Very true in terms of the one pocket which is the receivables pertaining to the JNNURM part, but I must also give you one impotent input and that with a few of them, I will not say all, but few of the STUs, we are also following the policy of collecting advance, and so truly speaking I do not expect the magnitude of the receivables on the STU front to be of that order as you are projecting, but certainly I agree with you the underlying current namely the pressure on build up of the receivables because of more sales to the other than the cash and carry segment will be more, that is one part. But the other side of the JNNURM part of it is most of that should get delivered in the third quarter itself. So, naturally by the yearend I should not have that much of volumes sitting in the receivables in my balance sheet part. Last piece I must say is that with the volumes going up, there is no way my production will be able to match my second half sales. So, there will be a significant eating into my current inventory levels of about 5900 vehicles. That reduction, coupled with the reduction on the production inventory part of it, all should translate to working capital levels that we are targeting.

Mr. Mahantesh:

Fair enough, sir. Sir, my second question pertains to the demand environment in the next fiscal year. We will have a new emission control kind of ushered in into the country that should raise generally the vehicle prices. If I look from the operator's perspective, then he is looking at a higher price of vehicle. He is looking at a higher rate of interest. He is also looking at possibly a higher fuel cost for himself. In such an environment and if I were to do a quick calculation, all of these point to an operating cost increase for a truck operator to be about 6% to 7%. With no commensurate freight rate increases, will that scuttle the demand?

Mr. K. Sridharan:

Yes, if your assumptions were to hold good, certainly there will be a drop in demand, but in my view your assumptions may not hold good. For one, the cost increases that you are referring to may get offset with some softening of the interest rate. Second, the cost increases on the fuel and other part of it may more than offset through a freight rate increase part. And third, very important point, with the growth prospects that people are taking about, say 8% GDP growth type of a thing, price availability will significantly soar up. So, all these would in my view point to, and this has been the practice that has happened in the last few cycles, if you see the trade cycles. The truck segment bounces with the vicious upturn registering some 25% to 30% type of a growth. Already, from a negative growth, you can see that this year we are all talking of 20% plus growth for the full year. It is purely because that I know the revival fine has happened and the revival on a month on month basis if you extend the trend, you will land up in this sort of a growth prospect.

Mr. Mahantesh:

Sir, I accept the arguments. But you know, I am getting worried about the return of the overload practices that the industry had to you know bear with few years back and that is generally depressing the freight rate environment and there seems to be no way with all to control the overload practices.

Mr. K. Sridharan:

Yes, I mean, as I said if your assumptions were to materialize then definitely there will be a drop in the demand.

Mr. Mahantesh:

Right, sir. Thank you very much.

Operator:

Thank you sir.

Next in line we have Mr. Sanketh from Span Capital. Please go ahead.

Mr. Sanketh:

Hello, good afternoon sir.

Mr. K. Sridharan:

Good afternoon.

Mr. Sanketh:

Just I wanted to ask about your raw material outlook on the second half and the next fiscal year?

Mr. K. Sridharan:

We expect that there will be an increase spike happening on the steel and the rubber front, but that would be subdued and hopefully will be deferred for the fourth quarter. And I do not expect in terms of the steel per se or the rubber per se could be around 10% type of an increase. I do not expect that on a vehicle level to translate to anything more than 1% or 2% for us. And going forward, I do not expect that neither the upturn nor the downturn will happen. Hopefully, we should be able to maintain with the commodity prices as it rules.

Mr. Sanketh:

Okay. And your Unit truck that thing was coming in Q3. What is the progress on it?

Mr. K. Sridharan:

Unitrucks is to be launched in the next financial year, which it is we call internally the future vehicle development program. That would be using the Neptune engine which is ready; it will also use the current cab as well as Next Generation Cab. So, that should get launched in the next financial year.

Mr. Sanketh:

That will be from Uttarakhand, right?

Mr. K. Sridharan:

It will be both from Uttarakhand as well as from the other factories.

Mr. Sanketh:

Okay. And sir, any pricing action in future?

Mr. K. Sridharan:

It is very difficult for me to say even if the price increase or the cost increases to happen beyond manageable levels, obviously both sides will take pricing action, which we have demonstrated it in the current year by taking two successive pricing actions, one in July and one in October. So, while I cannot predict any increase there, but I must say if the cost increases were to happen, certainly it will get passed on.

Mr. Sanketh:

Okay, because your competitors have already raised the price about 7% to 8% I mean compared to 3% to 5% you have raised.

Mr. K. Sridharan:

That is right.

Mr. Sanketh:

Yes. Okay. Thanks a lot sir. Best luck.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

Next in line we have a follow-up question from Mr. Alok Rawath from CLSA India. Please go ahead.

Mr. Alok Rawath:

All my questions have been answered, thanks.

Mr. K. Sridharan:

Thank you.

Operator:

Okay sir.

Once again, if you wish to ask a question, please press *1 on your phone and wait for your name to be announced.

Mr. Govindarajan Chellappa:

Kitty, if there are no more questions, can we conclude the call?

Operator:

Sure, but we have one question in the queue. Shall I take up that question sir?

Mr. Govindarajan Chellappa:

Yes, we will take one last question.

Operator:

Fine sir. We have Mr. Jayaram Nathan from Kotak Mahindra. Please go ahead.

Mr. Jayaram Nathan:

Thanks for taking my question. We are hearing some on the emission front there could be some delays. Can you just tell us what are you hearing on those fronts?

Mr. K. Sridharan:

Honestly, I have not heard of this delay. Whatever indications that we have, in all probability this will get implemented from 1st April 2010. Only window of opportunity or window of flexibility they offer is that the vehicles which are produced and manufactured and excise cleared before 31st March, can get registered with the registering authorities until May. In other words, they give about two months' timeframe for the body building and vehicle registration part. So, technically, rather practically speaking, the operators may have time until April and May to register a Euro-II vehicle outside the eleven cities. So this is the only window of extension that I can foresee.

Mr. Jayaram Nathan:

Okay. And secondly, my question on pricing, given that you have taken two price increases already this year, and the freight rates actually have not been going up anywhere. Do you think when excise duties get raised, in fact they will get raised next year, you will be able to pass it on?

Mr. K. Sridharan:

I must say Jayaram one point that the freight rates have gone up in the last three months. In fact it has gone up by more than 40% in the very busy route between the North and the East and has gone up by about 10% to 15% between the West and the South. So, I would just correct your impression that the freight rates have not gone up, it has significantly gone up. So, we need to really see how the future demand pans out as I was saying to the other question earlier, if the freight generating sectors register such a growth, I would expect the firming up of the price to continue and the viability of the operator remaining in good shape.

Mr. Jayaram Nathan:

Okay, thanks. And my last question on the UTK facility, what is the employment levels expected?

Mr. K. Sridharan:

It will be much less than the thing for a 50,000 vehicle, we will try and manage with about 1500 people, I mean that is the type of manning levels, but those manning levels will all happen only when we scale up the activity there.

Mr. Jayaram Nathan:

Okay. Thank you. Thanks a lot.

Mr. K. Sridharan:

Thank you.

Operator:

Thank you sir.

At this time, there are no further questions. I would like to hand the floor back to Mr. Govindarajan Chellappa for final remarks. Over to you sir.

Mr. Govindarajan Chellappa:

Yes, thanks Mr. Sridharan. Thanks for explaining all the queries, and thanks everybody for participating in the call. Thank you.

Mr. K. Sridharan:

Thank you Govind. Bye.

Operator:

That does conclude our conference. Thank you for participating. You may all disconnect now.