"Ashok Leyland Q3 FY2020 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day, and welcome to the Ashok Leyland Q3 FY2020 Earnings Conference Call, hosted by Nirmal Bang Equities Private Limited. As a reminder all participant lines will be in the listen only mode, and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call please signal an operator by pressing '*' then '0' on your touchtone phone. Please note that this conference is being recorded.

I now hand the conference over to Mr. Rahul Arora, CEO of Nirmal Bang Equities. Thank you, and over to you, Sir.

Rahul Arora: Thank you, Stanford. A very warm welcome to all the participants on this call, and a special thank you to the management of Ashok Leyland for taking time out this morning to do this call. The management will be represented by Mr. Gopal Mahadevan, the Whole-time Director and Chief Financial Officer; and Mr. K.M. Balaji, Vice President, Corporate Finance.

I request the management to make certain opening comments on the results, and subsequent to that, we can open the floor up for question and answers. So, thanks, and over to you.

Gopal Mahadevan: Yes. Thanks, Rahul. Good day to all of you. Thank you very much for the interest in Ashok Leyland. At the outset, first, I would want to say that we normally have the investor call on the same day or the next day of the results. But this time, we had a strategic planning session with the Board. So, we needed to complete that which is why we took it on the first day available to us, which was a Monday morning.

So let me lead you through the numbers, which I am sure all of you must have seen. So, I will very quickly, go through this so that we can have more time for questions.

The total industry volume for the quarter was 53681, which is about 39% lower than 87518, which was in Q3 last year. On a YTD basis as well, the total industry volume was 176202 which was again 37% lower than the same period last year. So Ashok Leyland volumes were slightly lower. They were about 16260 as opposed to 27943, and it is 42% lower, and so we did have a slight dip in market share, and I will tell you why it has happened.

On a YTD basis, our market share is almost flat, it is at 0.6% lower. In terms of the revenues for the quarter is 4000 Crores as opposed to 6300 Crores. It is 37% lower because the TIV is lower, and our EBITDA was 5.6% as opposed to 10.3% in the same period last year.

So I am going to now set a context to this whole thing. The reason why we deliberately decided to cede market share is we wanted to reduce the inventory in the system. As we are approaching March, I think what was important for us was to ensure that we do not push

inventory into the dealership. As you are all aware, ladies and gentlemen, our market share is determined by wholesale and not by retail. So what has happened is that we decided that we will not push more vehicles into the wholesale because that will only create challenges for the dealers because then they will be piled up with inventory, and that is not the spirit behind how we operate. Even if you remember in BS III to BS IV, we were the only player in the market who had written to dealers saying that if that is an issue, we are going to pick up the vehicles as far as the sudden transition happens. So for us, it is important that we have a long-term sustainable partnership with our dealers, and to evidence that, let me give you some numbers.

In June, when we were expecting that the markets will go up and this was not overstuffing in my opinion at all, we were expecting that after the stupendous win of the Modi government, that things will start going up. But we saw that the economic downside continued, in fact, accelerated quite significantly in Q2 and Q3. But at that point in time in June, when none of us knew that this was the kind of downside that will happen, the total inventory, I repeat, because there is a lot of misunderstanding in this call, so I repeat, the total inventory with Ashok Leyland and with dealers was 27500 units. I again repeat, it is not Ashok Leyland inventory, but the dealer inventory plus Ashok Leyland inventory was 27500 units. Today, as I speak to you, the very same inventory in the pipeline between Ashok Leyland and the dealers, the total inventory in the system is only 6500. So, what we have done was methodically clean up the inventory, and we said it is better to cede a little bit of market share than to keep pumping in inventory because from 31st of March, either the dealer or AL will be saddled with BS IV inventory, which will only result in losses. So the idea is not to look at short term gains, but to have a very clear transition plan into BS VI as we move forward. Now that has been one of the reasons why we have had this marginal market share reduction.

The second reason was also that we walked away from deals in which we had to lose money over variable cost. There is no way we are going to sell trucks losing money over variable cost because that is not the intention. The better way to do it is not to produce and sell them because then to produce a truck, sell them at a loss, not total loss, I am talking about competition selling, the trucks and buses, at the cost which is lower than the material plus variable, does it make sense to take all the trouble to produce and sell them at a loss, which is why we possibly were the only guys, again, who are transparent enough to share the plant shutdowns that we are doing, share it with investors because I think that is the best way to manage the company, be transparent, be clear about what your strategies are. Times are tough, but I am sure that we are going to get out of this soon.

The third aspect of it that I wanted to touch upon before you ask the question is our material cost is higher by about 4.5%. Here, the reason is, I would say, threefold. The main reason,

when I again repeat, the main reason, I am sorry, I am calling from home because I have a temperature, but I thought I would take the call, is the main reason is that we have what is called as inventorization reduction. I just shared with all of you that we have reduced the inventory in the company dramatically.

When that happens, the overhead that gets absorbed on those inventory gets released into the P&L and material cost. So what happens is when the overhead gets released into the material cost, the material cost will get impacted by that. So that itself, the impact is something like about 250 Crores for the current quarter. Nothing wrong with it. So why I wanted to mention that, while these are events that happen, but this is not on account of any sudden charge or on account of any untoward incident. It is purely because that, once you decide to reduce inventory, the overheads that are absorbed in that inventory, which are lying in those inventory, once you get reduced, will get into the P&L. The second reason has also been the mix. We have seen that the margins on ICV and in some of the bus STU tenders, the margins are slightly lower. So you would see an adverse mix, which has also played into the material cost, but that is lesser of an impact than the overhead inventory.

So I wanted to share this with you and set it in context. But most importantly, let me tell you that we are completely seized of the problem. We have a special crossover team, which is looking into the impact of crossover into BS VI, which we are taking steps to ensure that we are selling the inventory as quickly as possible. We are not adding to the inventory, and we want to minimize the losses that if we have into the BS VI transition. The K54 II initiative that I did talk about, we will hit the target of 500 Crores for the current year, and we will see that the full year annualized impact for next year would be something like 600 Crores to 650 Crores.

What I had shared with you earlier in the first quarter of the year or in the first quarter of the current fiscal was the VRS. We did go through the VRS, and we did shed about 250 people. Unfortunate, but we needed to do that because it was required to cut our overheads, and finally, there are special teams, which are looking at cost of quality, looking at expenditures, which are unnecessary in terms of inter-Regional Sales Office movements or packaging and forwarding in distribution, etc. The level of digital and data analytics that we are using is, by far, possibly the best in the commercial vehicle industry today, which is actually bringing our overall cost down, which is evidenced by the P&L.

You would have seen that the overall overheads have come off. Our manpower has come off. Manpower has also come off because of the reversal of some of the bonus provisions that we had carried because the performance is going to be significantly lower. There was no necessity for us to carry these provisions, and we have reversed that.

Having said that, also, on the Capex front, some of you had concerns at the beginning of the year when we said that we will be having Capex of nearly 2000 Crores. As on date, we have total Capex that has been spent is only 960 Crores, and we are going to be far, far lower than the projected Capex and we possibly will finish the year at about 1200 to 1300 Crores maximum, and our debt level position is quite comfortable. As of Q3, we are less than 2000 Crores of debt and last quarter, we were 2736 Crores of debt. Given a very tough quarter, I must state that we have done some very skewed cash flow management, reduction of inventory, all of which has resulted in cash flowing in, and we are doing everything that is right to build a long-term resilience of the company.

Having said that, now I am going to hand over the floor back to you folks for questions.

Moderator: Thank you very much Sir. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Ruchit Mehta from SBI Mutual Fund. Please go ahead.

Ruchit Mehta: Just 2 quick questions. One is on the BS VI production itself. What percentage of current production, I am saying as of this mid-February, would have shifted to BS VI? And what is the latest date by which you could actually shift BS IV vehicles into the market? And I am assuming here, you have those time line issues of buying the chassis and going for body building and then getting the final registration and etc., done? And second, just a clarification, the 6500 units that you said, it is as of today or it was at the end of the quarter?

Gopal Mahadevan: It was as of today. I will ask Balaji to give the break up after I finish this. We are doing trial production of BS VI because we are the only player who are not only doing BS VI, but we are doing MBP, Modular Business Program, as we call it. For us, this is going to be a medium-term strategic advantage, which will actually help us gain, I would say, customers over competition. We are very clear about that, and this will, in the medium term, when I say medium term at the end of 1 year or 1.5 years because these are large programs, and I think at the end of 1 year or 2, we would also see the benefits of commonization of parts coming in which will reduce inventory cost and complexity of manufacturing.

Having said that, as I told you, the BS VI trial productions are on. We have already started seeding vehicles. We have already seeded nearly about 60 vehicles on the road. We have test driven another 10 of them, over 6 million kilometers. All of which, we possibly are the only ones who have tested to this level of distance, and we are well on our way for the BS VI introduction. The BS VI introduction will happen in April. I do not think we will be selling earlier to that. BS IV production will continue until March, and as far as fully built vehicles are concerned, like for example, cab vehicles will continue till end of March because

registration is allowed till end of March. FES, or the front-end structures will continue possibly until end of February, unless the customer says that he or she is willing to take a front-end structure in March and be able to finish with doing the body building before 1st of April, and Balaji, can you tell me the 6500 is as of today, right?

K. M. Balaji: Yes. This is as of today.

Gopal Mahadevan: Yes. Can you tell the breakup?

K. M. Balaji: Yes, 3100 is with dealers and 3400 is with Ashok Leyland.

Gopal Mahadevan: Yes, very insignificant inventory, I will tell you, because we have really been able to do a wonderful job in bringing down the inventory and releasing cash flows, which is the right thing to do. For us, it is important that you get the resilience of the company up, and we will be ready for the new year than try to figure out problems of the old year.

Ruchit Mehta: Fair enough, thanks.

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

Prateek Poddar: So just 2 questions. One is, could you just talk a bit about the sustainability of this K54, which we have undertaken when we go into the next couple of years as to how resilient are the cost structure now? that is question number one.

The second question is, with Capex, which come down to 1200 Crores, 1300 Crores, and just looking at it from a medium-term perspective, how should I think about this Capex? And also, in addition to this, what has gone into cutting down the so Capex drastically in the last 3, 4 months. I mean it is commendable that from 2000 we have gone around to say 1300, 1400 Crores, but just trying to think about what went into this, and going forward, how should I look at Capex maybe as a percentage of sales, an absolute amount or how would you like to think about as your organization scales up? These 2 questions, Sir.

Gopal Mahadevan: We are actually, let me tell you Prateek, and most of the investors know it, I never like to overpromise and under deliver. But normally, it is better to take a longer-term view and then try to chip away. We have been really looking at how to get Capex down over the last few months that we have been able to achieve that. But having said that, as we move forward, I believe that we have also said, we have just finished our strategic planning process now and then we look at, how are we looking at this entire business. We have said that we need to get

this business into high ROC, and if we have to get back into ROC, we will have to do 2, 3 things, and which we have discussed earlier in the past.

One is to see that we de-volatized the company from the domestic truck business, even if it does awesomely well, which means we are extremely determined this time to grow our international, and more importantly, our LCV business, and the defense business also, we are taking some steps to see how to broad base, which I cannot share on the phone, but we are working on the project now to look at how to broad base the overall profile of the defense business, so that I can participate in a larger addressable market.

Parts business has been growing at 10%. I believe that it should be growing at maybe 15%. Again, we will come back with some plans in maybe a quarter or 2 from now as to how we are going to get there. But the idea is to see that we do not get into shrinking more because next year, the second quarter is not going to be really great, but we are going to use this opportunity even to scale down the operations of the company even further. What we are trying to do is instead of doing something like cutting ourselves to the bone, what we are saying is why do not we resize the organization to the level it was, say, possibly 3 years ago. So that is the thought. So we are going back. So, what I told the management was, let us go back to when we were 18000 Crores last, let us look at what were the resources we are deploying and let us take a 20% cut on that. So that has set the organization thinking completely differently.

Now when we are doing that, the sustainability of K54 will be even more next year because while we have looked at Rs. 500 Crores now, we possibly will be at 600 Crores, 650 Crores on an annual basis when we have full 12 months. Our plan for next year is going to be extremely aggressive, even though it is not easy to achieve. Believe me, some of these goals that we have set ourselves are so aggressive that we do not know, it requires a Rambo to deliver them, but I am sure that we will get there. It is extremely aggressive in terms of overhead than on Capex.

On Capex, I think where we will require Capex is on LCV business. We will be launching the Phoenix. We thought we will launch it in March, but this may happen in April or May, depending on the Wuhan, the vehicle is ready. We are very, very confident about. That is what we are very confident about the success of the vehicle because it is a very unique vehicle in its class, and actually, DOST is the only vehicle in the country today in LCV, which is not discounted. I do not know whether you know that. We do not sell DOST at a discount. So we are not planning to sell Phoenix at a discount also, and that is the plan.

Now the point is it has got some very unique features. It is got a walkthrough cabin. It is got the gear shift on the dashboard, which makes the driving very easy. It is comfortable to drive. The delivery, torque, turnaround radius is all state of the art, I would say, better than competition today. So it has got a very unique proposal, and we will see our market share in LCV growing up.

Now why is LCV important for us? Because we have again set ourselves a very big audacious goal. We have said that we want to be global top 10 in commercial vehicles over the next few years, maybe 6 years, 7 years, depending on how the economy pans out. If that has to happen, believe me 50% of our volumes will have to come from LCV, which means we need to have LCV volumes clocking somewhere around 150000 to 180000 or 200000 units. So LCV investments will happen.

So next year, if we decide to put some additional investment in LCV, that would be a separate carve-out. But other than that, our routine Capex, I do not think will exceed anywhere between 400 Crores to 500 Crores per annum over the next 4 to 5 years. I repeat, 400 Crores to 500 Crores per annum over the next 4 to 5 years.

We are making the company very asset-light. We are looking at our entire manufacturing strategy. Again, we possibly will shift some manufacturing and rebalance the whole manufacturing. There is a whole bunch of engineers that are thinking that is happening. That has been happening ever since Dheeraj started. So his focus was on long-term sustainability, and we are looking at that, and we hope to achieve that over the next couple of years.

Prateek Poddar: So Sir, just to summarize it, is it fair to say that K54 is structurally bringing down the breakeven points of the company? And when you are going to the next cycle, the cost structure will not inflate again. In fact, you would be much leaner than what you were in the previous cycle. Is that a fair understanding?

Gopal Mahadevan: Yes, yes. I would say like this, what we are telling ourselves is in the next cycle, we do not want to have any kind of pain.

Prateek Poddar: Sure, sure. That helps, and Sir, on Capex then, is it fair to say that worst case, I mean, 500 Crores is maintenance, and then you will have these projects, which would be, say, as you just talked about Phoenix and all, so around 1500 Crores. Is that a decent number to go with for the next couple of years?

Gopal Mahadevan: It would not be 1500 Crores also. I will come back to see, I will tell you, I am not able to tell the number now because, it will be a lot lower than that.

Prateek Poddar: And so this does not include investments, right?

Gopal Mahadevan: Yes. The investments in subsidiaries is the main subsidiary where we have a challenge is in Optare, and there, we spent about £10 million per annum approximately. So that is about 80 Crores, 90 Crores. Now we are trying to turn around the company. The good news in that company is that we are getting orders, and what has happened is most of the bus manufacturers in London have fallen off, and we have been very successful on our Electric Double Decker launch. So, we have, as I talk to you, we have this order for 90 buses from Roads & Transport Authority in Dubai. We have got the Metroline Double Decker order. We have got another order in London and we are also exploring orders in Australia. So these 3 are firm orders aside of the smaller offtake that happens. But the company is still far from being profitable. But what we are trying to do is to reduce the cash inflow. Other than that, I do not see any investment happening in Albonair as of now, maybe 3 million, 4 million. But other than that, I do not see any of our other subsidiaries taking any cash.

Prateek Poddar: Sure. So HFL.

Gopal Mahadevan: HFL may require cash investment, and the reason why we are having cash investment in HFL is to grow the book. It will be at 27000 Crores this year, and I know none of you asked, I thought I will take this opportunity to clarify. There is a 7% stake that Hinduja Group and Ashok Leyland has jointly decided to buy off Everstone. Apparently, there were some concerns in the market, please go back and refer in 2017. Ashok Leyland had bought 7% of Everstone because Everstone had invested into this in 2012, 2013, and I would say, Ashok Leyland, I mean we go by spirit than on letter, while there is no written commitment to buy off the shares, but there was an in-principle agreement that in the event an IPO does not happen, an exit will be provided to Everstone. Now we did try for an IPO twice if you remember. Unfortunately, every time HFL tried for an IPO, there was demonetization, and the next November, there was IL&FS crisis. So then that one, the DRHP had been filed with all facts. You would note that the DRHP has been filed and are in public domain. But then there was no sense in going for an IPO just for the sake of an IPO because this company is extremely valuable, yes? And so then we decided that we will buy off the shares, and at the moment, given the situation, and it is a very good price, let me tell you, 2x book is, when Cholamandalam is possibly at 3.74, 3.75x book, and Sundaram Finance of 2x book is very good. Even if we say that it is 2.5x book, and this is 2x 2019 book, not 2020 book. So this is a fantastic price. But I am afraid I played the prudent CFO and said, we will not buy the shares now. Let me see whether I want to buy something in the next tranche because I want to see the stable cash flow position before I invest into the shares because we have 62%.

But it becomes like, if I do make that investment, it helps because it can be part of my trade book in the event some other equity investor want to come in. But the reason we did that was only because we wanted to be committed to Everstone, and we have acquired the shares. At the moment, Hinduja Group London has offered to bail us out even though they did not want to. So they have taken the first 2 tranches, I do not remember the number of shares. But that is all that is to the transaction. I hope this clarifies.

Prateek Poddar: Great Sir. Thank you so much, all the best and wishing you speedy recovery. Thanks.

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

Binay Singh: Firstly, when you gave, share the number for 960 Crores of Capex for the first 9 months, what was the investment number for the first 9 months and for the full year 2020?

Gopal Mahadevan: Balaji, can you just share the number?

Gopal Mahadevan: It is 58 Crores for the first 9 months. For the first 9 months, the investment is 58 Crores.

Binay Singh: And the likely number for the year?

Gopal Mahadevan: Well, we are not yet clear. We may have to invest another £6 million to £7 million, maybe £7 million, another 56 Crores.

Binay Singh: Right, right, right. So that is a pretty tight control. Secondly, when you talked about the manpower provisioning into the staff cost, what was that number?

Gopal Mahadevan: Well, I cannot share those internal numbers. All I can tell you, because it is a very sensitive number for the internal purposes. All I can share is that the bonus reversals, unfortunate, but we had to reverse the bonus that have been provided for, and this has also had the positive impact of the VRS that we have taken. So the VRS, once it is done, the monthly manpower costs will come up after you take the onetime charge.

Binay Singh: Right, because what I was trying to say, what would be like a sustainable, because that is a very impressive number, like your manpower costs have come down.

G**opal Mahadevan**: No, to that extent, it would not be sustainable because the credit all of it for the past 3 quarters as such has flowed in. Here, all I can tell you is this because do not build a model just purely based on this, and I know you guys have to build a model. But as we move forward in a trajectory, we are still working on, like I mentioned to you, the strategy of the company is to

reorient the organization to an optimal manpower, which means we are looking at all functions and to look at the whole structure of the organization itself. We are doing a complete rehaul, and we have set ourselves, so next year you will see us actually come out with some hope. I mean I am not going to say anything now. Like I said, I never overpromise and under deliver on this. But we have set ourselves some targets, so let us see that it pans out.

Binay Singh: Right, I really look forward to that.

Gopal Mahadevan: But it is very sensitive. So we are doing everything that is possible and right. We possibly did let the middle line grow in the interest of growth because we did it, and I know that 1 year back, everybody was worried, including us, whether we will have the capacity to meet the demand. That was the question we had when we were at 85% capacity utilization. Now things have changed. But it will change, we have to be nimble footed as an organization.

Binay Singh: Right, right. Now could you also share the number for defense, spares like the revenue breakdown for the quarter?

Gopal Mahadevan: Balaji, can you just share the defense and spares numbers for the quarter?

K. M. Balaji: Defense for the quarter is roughly 1%, and spares is 9% of the total revenue of 4000 Crores.

Binay Singh: And how much will be LCVs and trucks?

K. M. Balaji: LCV is again 14% and domestic trucks is 41%.

Binay Singh: Great, great, thank you so much. Thanks.

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

Pramod Kumar: Gopal, just a clarification on the employee expense because you said the bonus provisions, which was provided in the first couple of quarters is reversed out in this quarter. So is it a fair way to say that if I look at the 9-month cumulative employee expenses, somewhere like 200 Crores, that should be like the run rate more or less sustainable one?

Gopal Mahadevan: Yes, more or less.

Pramod Kumar: Okay. Fair enough, and the RM cost, just a clarification on the RM side, you said there was a 250 Crores, 260 Crores hit because of inventorization of the rate. But that would be 6% of the revenue. I do not think it is not a one-off hit because accounting-wise, it should get set off

by the time you reach EBITDA, right? Because whatever the overhead you absorbed in the RM side is getting compensated by lower staff and lower other expenditure. Am I right?

Gopal Mahadevan: No, no, no. You are wrong, you are wrong. Because what happens, see, what happens is when you have, say, 10000 units is inventory steady state, what happens is that in those 10000 units, you would possibly have overhead absorbed in that. So when 10000 units are sold and 10000 units are brought back product produced, or 5000 units are sold and 5000 units are brought back as production and then you have 10000 units as standard inventory, the overhead is residing in those. 10000 units of inventory continues to stay in this steady state. What happens is the accounting is like this, you have manufacturing overhead, which is stated fully; and all other administrative areas, which is stated fully. In the inventorization, you have material plus manufacturing overheads plus plant-related admin overheads. All of it is getting inventorized. So what happens is in that inventory is residing the overhead on those 10000 units. So when that 10000 units get reduced to 2000 units, what happens is the material costs will be suddenly getting into a higher amount, right, because raw material, on a steady state, raw material costs get steady. But now suddenly the overhead residing there comes into the P&L, and when that happens, your manufacturing overhead continues to be shown at the same level, which is why you have the impact.

Pramod Kumar: So according to you, what will be the percentage reversal, which should ideally happen in 4Q now that this is kind of behind us because it cannot be clearly 600 bps, right, on the top line?

Gopal Mahadevan: Well, it cannot be 600 bps, but I will have to figure out because what is going to happen is, by 4Q, my inventory will be 0, yes?

Pramod Kumar: Yes. that is why you will take another hit there.

Gopal Mahadevan: Yes, I will take a hit, you are right.

Pramod Kumar: On the P&L. Finally, on the P&L, there is accounting, right? Then next year will be a clean slate in that sense once you start filling the BS VI.

Gopal Mahadevan: Yes, yes, yes.

K. M. Balaji: We are liquidating the 4500 vehicles, which are there in the inventory as of 31st December.

Gopal Mahadevan: It is somewhat 225 Crores to 250 Crores. I do not remember the number exactly.

Pramod Kumar: Given the way you spoke about BS VI production still being on the trial stage and the launch is largely in April, it looks like March is going to be practically none. There is not going to

be much of activity at the plant level. Is my understanding right, not only for you, but generally for the entire commercial vehicle industry?

Gopal Mahadevan: No. No. It is not like that. Actually, the activity is very high in March because that is where the trial production is where you have the maximal activity plus MBP happening, right, modular program happening. So the whole production line is being tested here. So there is a massive amount of action going on.

Pramod Kumar: No, but in terms of dispatch activity?

Gopal Mahadevan: Yes. The dispatch activity would not be high. But manufacturing, the testing will be huge.

Pramod Kumar: And finally, on scrappage, Gopal. That is been one thing which is still not happening. But can you just explain to us what would you see in the scrappage policy which would probably be a positive catalyst or the lack of that could make it a nonevent in terms of any particular, age criteria looking at, or whether it is voluntary or mandatory, anything which you can just like share your thoughts there?

Gopal Mahadevan: See, I think these have been discussed. That is why I did not even talk about it when the government has been mentioning about it. I think it will become very diluted then it has no impact. Because the guys who are going to get affected by the scrappage are not the large ones. The smaller ones, and I do not know whether the government is going to be, see, unless this scrappage policy is going to be very, very firm and mandatory, it will not have peaked. So what they will do, one of the suggestions that every year, you will have to pay 40000 additional as registration of something. For a guy who is got a truck, he would prefer to pay the 40000 additional than to go and buy a new truck at 20 lakhs.

Pramod Kumar: Yes. That is a fair point.

Gopal Mahadevan: Right? because the scrappage should have a purpose. If you say that old trucks should go off the road because they are polluting the environment, you cannot neutralize that by paying 40000. But we really have to wait and watch.

For me, what is going to be useful for the industry would be a mandatory scrappage policy, which means that it should happen, and this should be the cut-off date and trucks should have to go off the road. The second thing would be an incentivized scrappage so that the guys who have to scrap are given an incentive to scrap the older vehicles. Now if that is given, that will have a big plus for the large fleet operators who have been handling older fleet who can see that, okay, the return on new truck will be, net of the new investment, could be better, and then they decide to scrap the old vehicles. But the third and largely the most important thing

on this scrappage is going to be to have a good network of scrappage centers. That is important.

Pramod Kumar: Finally, Gopal, any numbers on the Ashok Leyland Finance? A major part of our investment has further gone up. So if you can just share how the quarter went past in terms of loan growth, NIMs or on the profitability side?

Gopal Mahadevan: I think profitability was good. I would say that at the end of the year, I will possibly share it, in the fourth quarter, Ashok Leyland, there are some constraints in sharing the number, but in the fourth quarter I will share, things are going reasonably well. There are no major hits as of now. I would say that the overall, we, of course, we have, because 50% of the book is domestic truck, but still I think that things are under control because of the diversified portfolio, and they should be at a book of about 27000 Crores. So, which is again about a 15%, 20% growth over the last year. So it is a very good growth. Company is doing well.

Pramod Kumar: Great Gopal and thanks a lot and best of luck. Thank you.

Moderator: Thank you. Next question is from the line of Gunjan Prithyani from JP Morgan. Please go ahead.

Gunjan Prithyani: Sir, I just wanted one follow-up on the Leyland Finance that you spoke about. Is there any repossessions or any increasing delinquencies that you are seeing on the portfolio?

Gopal Mahadevan: Yes, of course, we are seeing repos happening there. I would not say no. But overall, what happens is when you look at the overall profitability of the company, it does not come under pressure. The company has been able to grow its book, has been able to do buy-in and sell-down, has got a diversified portfolio and are both high-yielding. So I think it has been able to manage its performance well. Yes, there have been repos and we do charge off the cost of the repos every quarter. But to that extent, I would say that the accounting is quite conservative also, more conservative than some of the other finance companies, well-rated finance companies in the country.

Gunjan Prithyani: But would you be able to share the asset quality numbers in this call? Or you will do it next...

Gopal Mahadevan: Not in this call, but I will share it possibly in the month of March. But there is nothing to get too worried about on the asset quality at all. Let me tell you that.

Gunjan Prithyani: No. It is essentially coming from just that most NBFCs have been talking about more stress on their CV book and increasing repossessions. So I am just trying to get some sense from you on the health of the underlying market because clearly the volumes do not, I mean,

volume trends have remained very depressed despite some manufacturers coming and saying that prebuy is coming through over the last 2, 3 months. So despite that prebuy volumes have been so muted and we are having these incremental concerns around repossessions. So I am just trying to understand if you can give us some sense on what is happening at the fleet operator level in terms of utilization levels or the fleet…

Gopal Mahadevan: I would say that the company has had challenges more on the smaller first-time buyer, first-time user segment. There, we have seen the asset quality, I mean, where the repos service has been higher. But see, I cannot only talk about one segment where the performance is bad because as an investor, you will look at the company as a whole. Like, for example, my truck business is not doing well. Of course, it is a major business. But our other businesses are doing reasonably well, including LCV. So when I look at the overall book, that is why actually their exposure, unfortunately, for example, if you take other OEs who are actually funding their domestic truck business, the exposure of Hinduja Leyland Finance, in the share of financing of Leyland, this quarter was only 7%. So we have kept it at an arm's length. We are not pushing it far. It is independently managed.

But I will be able to share more greater details in the month of March. So far, we have not been sharing because it is privately held, and I would want this transaction to go through before I could share anything. There are certain issues due to which we are not able to share.

Gunjan Prithyani: Fair enough, and more generally, if you see that level of repossessions have increased in the market, does this have any bearing on the new vehicle sales going into next year?

Gopal Mahadevan: I do not know because if that is the case, see, next year, it would not have any impact because next year will be BS VI.

Gunjan Prithyani: But in this prudent market the BS IV vehicles can get sold, right?

Gopal Mahadevan: No new registrations will be allowed.

Gunjan Prithyani: Repossessed trucks…

Gopal Mahadevan: We will have to wait and watch as a lot depends on the demand pattern for next year.

Gunjan Prithyani: Sure.

Gopal Mahadevan: Well, the assumption is that at the current level of economic activity, things should only get better. So, we will have to wait and watch.

Gunjan Prithyani: Okay. Got you, and the second question I had was on the China sourcing. You mentioned about the LCV platform, that there could be some deferment there. I am just trying to understand what is the extent of reliance on China, and do you see any risk around that given the whole virus issue?

Gopal Mahadevan: No. Actually, this is not a Chinese vehicle. What we have done is only done the toolings. So the final set of toolings have to come. All aspects of manufacturing of the vehicle will be done only in India, 100%.

Gunjan Prithyani: But any, I mean, for even your current portfolio, any component side risk that will...

Gopal Mahadevan: That will happen for BS VI because companies like Bosch, etc., have their exposure to China. So Bosch is affected. Like, for example, if you remember in 2017, when fuel injection pumps fell into a shortage because the Chinese manufacturing units could not cater to the demand because of Bosch fuel injection pumps. So that is indirect exposure. But we do not have any major exposure to China.

Gunjan Prithyani: But indirect exposure also, to just get clarity, it is not there on BS IV. It could be on BS VI is what you mean to say.

Gopal Mahadevan: Yes. BS VI, it is there. Even for BS IV, it is there. Bosch, I mean, the fuel injection pumps, there are so many other things, which are actually imported by our OEs, suppliers and then provided to us. But at the moment, for BS IV, it is not a concern because volumes are tapering off. But for BS VI, there could be.

Gunjan Prithyani: Okay, and anything you can share on the price increases for BS VI? Has the pricing strategy been decided?

Gopal Mahadevan: I wish I could because I do not know the number myself. We will have to wait and watch what the competition is doing. See, all I can tell you, and I do not want to wet anybody's appetite, but in BS III to BS IV, we were the only guys who have raised prices by 14%, if you remember. Nobody else did. We were the only guys who have raised prices because that is the rational thing to do. I think investors are very worried, why did we do that. But then we were able to sell the product. At the same time, we are now waiting and watching to see what is the overall demand condition, and then we will take the call suitably.

Gunjan Prithyani: Thank you so much.

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

Kapil R. Singh: I just wanted to check on the overall demand environment, if you could share some thoughts as well. Just very broadly, what are you hearing? And what do you expect? Because there has been talks of some green shoots as well. So your thoughts on that, please?

Gopal Mahadevan: See, I would classify this entire demand thing into possibly 3 buckets: One is sentiment. The second one is underlying economic growth. The third one is industry-specific.

So if you look at sentiment, I think the sentiment is very low. So there is no incentive for people to buy anything, leave alone trucks. You are seeing even FMCG sales coming off. You are seeing all major industries coming off. Capex has not been set up. The government is trying to do various things to incentivize, but it is not happening. Sentiment is at all-time low, and I think a lot of global trade, commerce and stock markets and cash flows rely on sentiment more than anything else.

The second thing is underlying economic growth. I think at the moment, the economic growth has to be seen. But we have been seeing now 6 quarters of lower economic growth. Thankfully, it is not a recession. But we need to ensure that the economy is pumped, and some of the initiatives that the government is looking at in terms of reviving the industry has to be done very, very quickly, not only the industry, the economy. So the investments and infrastructure, the commencement of a lot of economic, I mean, I would say, in fact, more than the infrastructure, roads, ports, etc. are being done. It is how it needs to be done. Immediately after World War I, that is what the American President had said, "Let us build roads." So it is important that the government starts to kick start this investment-led growth. Otherwise, it is going to be very, very unfortunate.

The third one is industry-specific. While roads, construction is going on, but I think what is happening is that most of the other industries have not seen anything happening, and also, you see a lot of collateral work happening, which is dampening the industry. Like, for example, the way the telecom industry is going through the challenges. So you have seen a whole bunch of things happening. So for us, when we are doing our planning exercise, what we have assumed is that maybe next year, you will see Q3 and Q4 actually showing growth. Q1 is not going to be a great quarter. Q2 could be flattish. But Q3, Q4, we are preparing ourselves for a growth, and at some point in time, the demand will start. So we do not want to be despondent, but at the same time, we said if we do not use this opportunity to restructure our organization again and not just cut down costs, which means we resize the organization to something like an 18000 Crores organization or even lower, and drive productivity through using digital, using analytics, take out unnecessary efforts that we are putting into various things, conserve all the resources for product development and conquering new markets,

reduce the overall service cost to the customer and improve the dealer profitability, then we possibly would see a much more resilient company, which is what we are trying to do.

Kapil R. Singh: Okay. This is quite helpful. Secondly, I just had a clarification request on this inventory number of 6500. Is this including LCVs or this is only MHCVs?

Gopal Mahadevan: Well, this is only MHCVs. LCV inventory is hardly, I think, 10 days. It is not at all a concern.

Kapil R. Singh: Okay, and you also mentioned that inventory has been...

Gopal Mahadevan: The inventory is including dealers and our selves.

Kapil R. Singh: Yes. Yes. Understood.

Gopal Mahadevan: Our inventory is only 3000.

Kapil R. Singh: Yes, and I also wanted to check. You mentioned that at the end of March, the inventory would be 0. So why is that we would not be doing BS VI shipments in March?

Gopal Mahadevan: We are not looking at doing any major shipments in March. See, well, it is 0. It is not 0 yet. It is virtually 0. We do not expect it to be huge.

Kapil R. Singh: Okay. So the shipments would be very less in March, basically that is what you indicated?

Gopal Mahadevan: Yes. Yes. So we are not going to pre-produce and keep everything here. We will see, 1 quarter, etc., it is all fine. See, there is no point in getting overexcited about something when things are uncertain. I want to keep it tight, see the whole main thing is to hold on to cash. We are able to do that. From 2700 Crores, we have brought the cash up, borrowing down to 2000 Crores. So we need to keep our cash levels better.

Kapil R. Singh: No, I am just wondering, if there is some improvement in demand, how are we going to service that if you do not have inventory?

Gopal Mahadevan: No, we will manage it. For whatever information that we are getting, we will do that, and anyway, the plants are free so there would not be any difficulty in producing.

Kapil R. Singh: Yes, and Gopal, just a question on repossessions. I know, I mean, you cannot share any numbers. But I think broadly, what we are hearing or the concern from the investors is that the repossessions, at what level are they? Are they at an alarming level? Or they are high but not really alarming?

Gopal Mahadevan: They are high but not alarming.

Kapil R. Singh: Okay, right. Thank you, that is it from my side.

Moderator: Thank you. The next question is from the line of Sonal Gupta from UBS. Please go ahead.

Sonal Gupta: Just a couple of things. One, on the export side, could you give us some color as to how do we see next year for exports? Are there any markets or any specific, like because, obviously, the domestic environment is uncertain. But exports, can we expect anything significant?

Gopal Mahadevan: Next year, well, let us hope that we are able to grow our exports by 20%. That is our target.

Sonal Gupta: Okay. Sure, but any specific market expectation or industry, I mean, like is it this country-specific? Or is it more like that you are entering some new markets and that is how it is it is all drive at?

Gopal Mahadevan: No, we are expecting a growth in African markets because there are a lot of tenders that are coming up there, which we have bid for. Second one is we are expecting the Bangladesh market to revive. It has been 0 almost this year. So the Bangladesh market will definitely revive, and Sri Lanka, also, we are expecting a couple of tenders where we should win. So that happens again. These are the 3 main markets.

Sonal Gupta: Sure, just one small question. On the revenue, you have shared most of it. But can I get for domestic buses and exports also then overall revenue?

Gopal Mahadevan: Balaji, can you give that?

K. M. Balaji: On buses, it is 20%. Domestic buses, it is 20%, and exports, it is 9%.

Sonal Gupta: Okay, you mentioned in some of your comments that you are working on the defense side to scale this up. I know you said that you cannot share details on that, but anything that, I mean, like because this thing has been stuck at like 400 Crores, 500 Crores a year for a long time. So anything that we see changing in the next year or so?

Gopal Mahadevan: I do not know, to be honest. I think as far as exports are concerned, to be honest, I think we possibly were too optimistic about ourselves in the past. But you would never have heard me say that. I would always be a little more tempered down.

But as far as defense is concerned, we have won nearly 30, 34 tenders, and we have won the tenders. We have submitted the orders. I mean we have also completed those orders. But the

initial orders will come only for 2, 3 vehicles. But now the government has to order. The government is not ordering. If that had happened, our revenues would have doubled. Unfortunately, that is not happening. So what we are now trying to do is, okay, we tried this. It is not working. We will wait for the orders to come. But the next thing that we are doing now is we are saying like let us broad base, the capabilities that we can have in terms of seeing a larger addressable market in defense, which is our overall plan. This is not a short-term plan. This will take 2 years at least.

See, the idea is to tell 2 years or not because we want to push it away into the future. Unless I take the steps now, I cannot get it done. So we are looking at everything anew because we have to ensure that we devolitize the company, that is for sure, and we want to ensure that we are profitable and you see, we want to be like this where even if the industry volumes were to come down by 40%, we would still remain profitable and that we do not get into such deep cuts in profits.

It is becoming important for us because this kind of tidal wave of just feasting and fasting cannot go on like this because the company is getting into larger and larger revenue pools, but at the same time, it is still as susceptible as it was. The company is as susceptible at 9500 Crores as it was in the 30000 Crores. We cannot have it like that anymore. So we have decided to cut it out now. I am personally working on the strategy.

Sonal Gupta: Sure. Thank you Gopal, thank you, thanks a lot.

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

Nishit Jalan: Congratulations on good cash flow management, at least, in a difficult quarter. Sir, I have 2 questions. Firstly, on the debt side. We still have about 2000 Crores of debt. I have assumed this is largely related to working capital, basically your payables are coming down. We would not have any term loans of any long-term debt as such, right?

Gopal Mahadevan: No, we have term loans because I strongly believe what shall I say, I am a little old-fashioned, and that has actually stood the company in good stead. So I keep long-term loans in long-term loans, and I keep short-term loans in short-term loans. So for me, out of the 2000 Crores of debt that I have, right, my overall, my total borrowing is 1903, out of which I think we have about 80 million, 80 million is about 1000 Crores, if my memory serves me right. Sorry, I do not have the number, but I am just giving you an approximate number. About 1300 Crores of long-term borrowing and short-term borrowing is about 522 Crores, and these do not come for repayment for another 2 years. I have deliberately kept long tenor because it is

easier and it eases the pressure on the system, and it has got prepayment options so there is nothing to worry about. If we really get some cash, do not worry, we will pay.

Nishit Jalan: Sir, what I wanted also to understand was, is there a scope to reduce working capital further? And I would assume that payables right now would be really low because the production run rates are much lower than sales levels. So do you think that working capital will get further released in the next few quarters, and which will help us reduce our debt levels?

Gopal Mahadevan: Yes. There are some sides on the asset side, which we are trying to do because we are trying to liquidate the inventory. So that will help us a little bit to reduce the cash a little bit, I mean, increase the cash flows a little bit more.

Nishit Jalan: Okay, and secondly, can you talk a little bit about discount situation right now in the industry? Have they gone up really high? And if you can throw some numbers as to what it is today and what it used to be in a normal scenario, that would be very helpful.

Gopal Mahadevan: The discount levels are still high. So these are very average numbers. They defy any logic, to be honest with you, and they are at 5.25 lakhs on an average on a vehicle, and it is very, very difficult, they are about 5.25 lakh on a vehicle. They have gone by about 25000 on an average. But this quarter, we have witnessed some deals being taken off as which are going at 7 lakhs, etc. It is ridiculous to, I mean they are selling at 24 lakhs, 22 lakhs, 23 lakhs and say, "I will give a 7 lakhs discount." I mean I do not make that kind of money.

So it is very desperate. I do not understand the game, I think competition is in the game of acquiring market share at any cost. We are in the game of certainly acquiring market share and growing the business. There is no doubt about it. But I do not want to make a loss. So for me, if it is marginally positive, I am taking the deals because it helps me to liquidate the inventory. Do you understand? But at the same time, we have to ensure that we do pursue market share. That is why our market share drop has not been significant, if you noticed, because we have also taken deals at higher discounts, but not at a loss level.

And for us, so let me tell you, market share is very, very important as the company. I mean that is why it is one of the most important metrics for our bonuses also. If we do not achieve market share, we do not get bonus. So for us, market share is very, very important. We want to grow. We want to be in a leading position. But we have to ensure that we are doing it in a methodical manner. That is all.

Nishit Jalan: Thank you.

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

Gopal Mahadevan: Thank you for your patience, ladies and gentlemen. I think we had some good discussion. All I want to tell you is that we are doing everything that is right. We are not going to do anything that is going to harm the company in the short term. I can only tell you that for us, being a significant player in the Indian domestic market is very important, and we would want to, and our plans over the next few years reflects that. Methodically, we will continue to gain market share over the next few years so that we are in a position to challenge some of the larger players. Very clearly, we are not going to shy away from growth and leadership in the domestic market, and we will ensure that we are in a more capable position by taking cost out of the company and ensuring that our products perform much better than competition and the customer also gets a product that he wants in modular business program. So these are very important, well thought-out strategies, which will help us to acquire customers and retain them as well.

We are also growing the network in the north and the east, and you would see a greater presence in the year to come. We are also doing synergies. There are a lot of synergies between LCV and MHCV, and you will see that we would have common dealer families between both, which will actually kind of cross-subsidize each other and help the entire dealer family to grow as well as the company also to grow. LCV is another huge business potential for us, and we are very confident about the growth this business is going to post. We will continue to make investments into that business as we see growth happening. We are not going to put money first and growth later. The philosophy here now is show the growth, and we will start putting money very quickly and scaling up very quickly.

We hopefully will be posting more resilient and larger export numbers. We have completely changed our export strategy. We have actually reduced the level of activity in Dubai. We are bringing it back to Chennai because that is where the action is, and we are bringing senior leadership back here, and of course, now the revised structure with 2 Chief Operating Officers being on the Board, then we have a new CEO, all of it is going to help us to revitalize ourselves, and I think among CV players, we are still the best and the most profitable, if I am right. I do not know. But I think that speaks wonders given the fact that we still been able to maintain the EBITDA margin almost at the same level as the last quarter. Despite having a 200 Crores charge on account of inventorization, despite having heavy discounting, we not only have been able to just manage to maintain the EBITDA margin, we have also been able to improve the cash flow position. So remember that you got a great team here who is making the impossible possible.

But of course, the market should help. The market should grow. I expect to have the same level of profitability as when the market was doing very, very well. But having said that, in the next cycle, that will happen. I am sure that we are going to be far, far more resilient than we are today, and we are hopeful that Q3 and Q4 of next year is going to be a correcting point, an inflection point for growth to happen, and we will be tight on Capex. You have seen our Capex numbers, originally 2000, now 1300 or so. Investments also have been brought down quite significantly. So be rest assured that you have a very prudent management team who is working on this.

Thank you very much, and have a good day.

Moderator: Thank you very much, Sir. Ladies and gentlemen, on behalf of Nirmal Bang Equities, that concludes this conference. Thank you for joining us, and you may now disconnect your lines.