"Ashok Leyland Q1 FY17 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Ashok Leyland Q1 FY2017 Earning Conference Call, hosted by IDFC Securities Limited. As a reminder, all participant lines will be in the listen only mode and there will be an opportunity for you to ask questions after the presentation concludes. 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 would now like to hand the conference over to Mr. Deepak Jain from IDFC Securities. Thank you and over to you Mr Jain

Deepak Jain: Thank you Karuna. Good morning everybody, we are delighted to have with us the management of Ashok Leyland, which is represented by Mr. Gopal Mahadevan, CFO and Mr. K.M. Balaji, General Manager (Corporate Finance). Over to you Sir!

Gopal Mahadevan: Thank you. Thank you everyone for the interest in Ashok Leyland and thank you for joining the investor call. I am very happy to share that we are having the 9th quarter in a row when we have been exceeding the domestic volume, in terms of volume growth in the domestic market. We have shown a volume growth of 18.5% in domestic market. The volume growth that the domestic market had was about 14.5%. Our revenues have grown at 10% and the EBITDA for the quarter has been 11.2%. Our PAT has grown at about 101%. If you were look at the breakup of market shares, our market share has grown from 30% to 31% overall and in truck it has grown from 29.2% to 30.1% and in bus we have grown from 33.2% to 35.9%. So our position, I would say as one of the larger player in the domestic market continues, where we have seen a little bit of lag on the export volume, which constitute about 7% of our revenues, but as we move forward, we are pretty confident that we will able to catch up because this quarter we actually had some delays in invoicing because we had to wait for certain LCs to be opened and all of which is actually getting set right in Q2.

Another important highlight in this quarter has been that our interest costs have come down significantly over the same period last year and our debt levels are at about Rs.1600 Crores, which is just about 0.3:1. You must remember that exactly about three years ago, our debt levels were at about 2.25:1 so there has been a significant amount of reduction in debt. And overall, we have seen the operating leverage catch-up. The efforts that the company has been putting in terms of driving down the costs, driving down material costs, overheads, improving the operating leverage, all of which seems to have paid-off in the current quarter as well. So having given this brief introduction, what I will do is, I will now throw the floor open for questions.

Moderator: Thank you very much. We will now begin the question and answer session. We have first question from the line of Jay Kale from Elara Capital. Please go ahead.

Jay Kale: Thanks for the opportunity and congrats on a very good set of numbers. Sir my first question was regarding the volume growth. We have seen that 1Q FY2017 has been some kind of moderation in volumes, given that FY2016 had a very strong growth, also boosted by some regulatory norms and

FY2017 would also kind of have some spurt in volumes before the BS-IV norms come in. What would be your outlook for FY2017 and given that outlook going forward in FY2018, you have a lot of replacement sales already come up in the last two years because of these regulatory norms. Would you see that the base would catch up in FY2018 and you would see a moderate growth over there?

Gopal Mahadevan: I think, yes, everybody has been concerned about this moderation in growth. Let me put this in perspective. First of all at the beginning of the year, we did mention that we expect the industry to grow at about 15% to 20% and that is where we are in Q1. The industry has grown at 14.5% and therefore Ashok Leyland has beaten the industry volumes and it has grown at 18.5%. But we must remember three years back, the total industry volume was 200,000 grew by 16% to 230,000. Ashok Leyland grew at 28% then and then from 230,000, it grew at 30% and it was about 300,000, Ashok Leyland grew at 50% last year. Now even on that, we have posted an incremental growth of about 18.5%. So the industry also, we must understand is having a larger base but having said that, this still continues to be one of the larger growing industries in the economy today, point one.

Point 2, as we see now, the situation seems to have been significantly better than what it was at the beginning of the year. We are seeing that the infrastructure initiatives of the government, the investment led growth initiative of the government are more visible today. We are seeing the pace of road laying has significantly gone up, the government state that is nearly 21 kilometers per day, that is really a pretty, I would say a high number. We are seeing mining sector getting opened up, even within ourselves or even within Ashok Leyland, if you were look at it, our tipper volumes have grown by 100%, which kind of gives an indication that things are looking up. Having said that, so what we are going to see happen in the industry is two parts. One is we are going to have the investment led strategy of the government, if that is pursued we are going to see a favorable effect on the volumes. The second one is what you rightly said about the implementation of BS-IV effective April 1, 2017, now if that is going to happen there is going to be quite a bit of pre-buy that is going to happen in Q4. All of which augurs well for the industry. If the economy does not grow, as forecasted now today we have seen S&P upgrading the growth rate to 8%, if all of this were to happen, I think things could move even better, but at the moment we would like to maintain the outlook at about 15% to 20%. Let things pan out but they look positive as far as we are concerned.

Jay Kale: Okay but then would largely all the replacement sales would have come in FY2016 and 2017 and say FY2018 would be led to largely only the economic led activity growth. If I am not wrong 60% of the industry sales come because of replacement and 40% because of the economic activity. Is that number correct?

Gopal Mahadevan: Well these are statistics. We have certain numbers, which are internally different, but what I would say is that there is a sum that comes from economic led activity and there is sum that comes from replacement, but there are other things, which are also actually moving very favourably for the industry. If you are going to look at it, if we actually move into rated capacity for instance, the market

is still overload, if you go for rated load there is obviously going to be more volume that is going to happen. Of course the economics of the fleet operator is the same, but the rate of load is going to definitely auger well. Similarly any changes in technology including fully built vehicles will augur well for leading players who have the capabilities and the capacity to deliver these requirements. And if road infrastructure is going to improve, as the government is promising, this is going to have a very, very positive effect on the industry. Last but not the least the implementation of GST is another big positive for the industry. So at the moment, I think there are two parts to this one is yes, the industry had degrown significantly so we should look at it as yes, and the industry is catching up. I mean, I am not going to say that there is a base effect and the scheme is coming up, yes at any point in time and any industry kind of growth at which it has been growing obviously there will be a certain amount of catch up that will happen, but then as we move forward thing seem to be looking very positive for the industry and we must understand the base of the economy has also changed from what it was about five to six years ago, so if the economic growth does happen then we are going to see something positive for the industry. At the bottom of it let me assure you there is only so much of replacement that will keep on coming, at the end of it what is going to drive the truck business is that more and more goods have to be transported which is the basis of the trucking industry.

Jay Kale: Sure and just one last question, on the discount side, how have you seen that trending and if you can give a number to it for this quarter?

Gopal Mahadevan: See like I mentioned to investors, in the earlier calls also, we really do not see discount as an absolute number. What we look at is absolute margins, so what we see is, in each of these businesses, especially on trucks and buses and in each of the product categories within these segments, are we having margins, which are improved. And I am happy to state that we have been able to post better margins quarter-on-quarter and that is what we pursue as a strategy. What we are pursuing, let me share with now is that we need to grow volumes, we need to grow market shares, so we need to grow better than the industry, that is one.

The second most important thing is we have to make this growth profitably. So we have to ensure that we have the right mix of products, product cost efficiencies are kicked in, our operational efficiencies are kicked in and we are able to make this growth profitable. So there is no point in just having a discounting war on selling, giving away trucks, we do not believe in that.

The third most important aspect of this growth is to see whether I am growing geographically. Within India, am I really a pan India Company, which I am today? The growth that has happened is actually in the North, East, Central and West zones. South has been a tad low, but we will catch up but there has been a huge volume that has happened there, then we have a huge market share there.

So am I growing geographically within India? Am I able to reach out to more customers? Do I have more service networks in place? That is what we look at. If you look at it over the last five years, we have actually kind of quadrupled our points of presence.

That is important and the second geographical presence that we are looking at is am I growing my international revenues? Am I putting in place the building blocks for me to grow my business in the international market where we have stated that over the next five years, we would like to see exports to constitute at least 30% to 33% of our revenues? So all those efforts are coming in, so just looking at discount is just one bit of it. I can give you a number, it is about 2.25 lakhs to 2.35 lakhs, it does not mean much to me because these are averages, but what matters is am I growing profitably, am I able to realize realization better and for that my answer for this quarter is yes.

Jay Kale: Great, thanks and all the best.

Moderator: Thank you. Next question is from the line of Ashish Nigam from Axis Capital. Please go ahead.

Ashish Nigam: Gopal, congrats on a good quarter. So just two questions, firstly, how do you see capex going ahead? I think we are currently at 70% utilization on two shifts. So going ahead, would we add another shift and then think of fresh capex? How are you seeing this?

Gopal Mahadevan: Yes, see our capex, we had at the beginning of the year given an outlook that it should be about Rs.500 Crores including investments I repeat including investments into other subsidiaries that we want that may require funding that is where we are looking at the number, that is where it will be. We are at about 70%, 75% utilization, depending on the absolute demand supply requirement that we have, I must compliment our operations team and base team, the way we are actually looking at supply chain management and deliveries, because we are optimizing the way the manufacturing capacity has been utilized not only in terms of timing of manufacture, but also in terms of location. As far as the two shifts to three shifts are concerned, I think yes, there are certain places where we may go to three shifts, but not at the moment. Currently, we are running at two shifts except for certain critical areas like, for example the paint booth is 24 hours, we cannot run it for two shifts, we cannot shut down the paint booth. But there are one or two areas in the manufacturing area where it is around three shifts, but otherwise we are predominantly a two-shift operation. We are not, I think as we move forward the capex will be for debottlenecking some of the capacities and that is what we are working on. I do not see a big amount of capex happening in the current year or next, because we are one of the few players in the industry who have an absolutely current offering in the three of the critical elements of a truck, which is the engine, the cabin and the chassis. So whatever investment we have planned, we have finished a huge incurrence of capex for the Pant Nagar facility, some of the new products, the Neptune engine as well as for refurbishing the Ennore facility. And we have been continuously rebuilding the capacity even in Hosur as well. So I think we are reasonably on track in capex.

Ashish Nigam: Okay, that is helpful. Okay. So just secondly wanted your thoughts on defence. I know we have an optimistic outlook over the next maybe four to five years. But how will things shape up in the next, in the medium term in the next year or so. Is there anything on the anvil?

Gopal Mahadevan: We have won 11 tenders and we are in the process of executing them, but for confidential reason I cannot give an absolute value to that, they are not very small orders let me only tell you that but more importantly, and we are one of the largest logistic vehicle providers for troops, military troops in the world and in India as well. So far us, we are going to leverage on all this presence and we are going to offer mobility solutions. We have been offering mobility solutions for troops. We are saying let us expand the solutions for this. So if you look at, once you do that as a strategy we have got a much larger base on which we can expand our defense business and we are in discussions with technology partners as well because if you have to have a multi-barrel rocket launcher (MBRL) on the back of a truck, which we have already built by the way. As you know, the qualities and aspects of the truck are distinctly different. You cannot have one-micron variation when the MBRL fires. So I think for us in the medium term, we are looking at this at $750 million to $1 billion business over the next five years and that is why we are progressing strategically.

Ashish Nigam: Okay, can you just remind us, what was the number in FY2016 because I know you are clubbed with spare sales we do not have the actual number?

Gopal Mahadevan: What you want, sorry I did not understand.

Ashish Nigam: The defense in FY2016?

Gopal Mahadevan: I will ask Balaji to share that number a little later, but defense typically constitutes about 4% to 5% of our total revenues.

Ashish Nigam: Thank you.

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

Basudev Banerjee: Congrats on great set of numbers. Few questions. In your press release, we can find year-on-year comparable Ind AS restated numbers. So just wanted to understand from a sequential perspective, if one benchmarks the previous quarter reported numbers, your gross margins have improved significantly, despite steel and other raw mat prices increasing. So can you throw some light on the restated numbers post Ind AS of the last quarter?

Gopal Mahadevan: Those are not published, so I cannot comment on them, my dear friend, because if you are asking for restated numbers of March quarter, those are not published. So I obviously cannot disclose that.

Basudev Banerjee: But from a gross profit angle, what has been the trend?

Gopal Mahadevan: I do not think Ind AS matters frankly whether it is Ind AS or Ind GAAP or any other GAAP, that is not going to determine my margins.

Basudev Banerjee: Sir, not margins, but constituents of margin within that there has been some shift from raw material to other expenses. So with that regard?

Gopal Mahadevan: No, I do not think there has been any major shift on raw materials to other expenses and all that. I do not think there has been any major shift from raw materials. Balaji, you want to say something.

K.M. Balaji: There is not much of a change compared to our earlier practice.

Basudev Banerjee: So then on what aspects you can signify that your gross margin, which has improved almost by 200 BPS sequentially despite all raw material prices increasing so any major skewness in your defense spares revenue this quarter or any major improvement in mix? Or the low cost inventory of raw material you utilized and in next quarter margin, the real impact might get reflected. So anything on that angle Sir?

Gopal Mahadevan: Yes, I think one of the things, one of the reasons has been that we have had a favorable mix and we have been driving that mix also. That has helped us and whatever exports we get would constitute about 7% of our volumes has again been reasonably profitable. We have done about 750 kits. I think that is almost the same as the same quarter last year, but overall the mix of the products have enabled us to get better margins and we must remember one thing while the raw material prices have increased, we have also increased prices. So in April, we did increase prices. We do not believe in this discounting beyond a point. And we do not push stock, as it was mentioned by some media. We do not do discounting as a lead indicator for us to drive business. So we are very, very clear that, if we have to grow, we have to grow profitably, at the same time I do not want to sound very strange on this, but the point is that, yes the margins are an effect of two things, one is the pricing effect that I take on the sales side. The second one is, I would say, the mix of products. The third thing is, of course, the impact of raw material prices and of course, the fourth one is how I am driving my operational efficiencies. How am I driving my material cost? How am I driving my bill for materials? How am I driving my manufacturing overheads? All of this matters when you do a gross margin, so I think we have been able to neutralize to a certain effect the increase in steel pricing. That is one of the things that have happened. But as we move forward, we will focus on increasing prices where necessary. I presume the industry would also be rational enough to pass on raw material prices to customers and we will continue to work on our operational efficiency. This has got nothing to do actually with Ind AS accounting.

Basudev Banerjee: What was the quantum of price hike from April as you said?

Gopal Mahadevan: About 1% to 1.5%.

Basudev Banerjee: Sir, if I look at the reported numbers and divide it with a reported volume, the net realization on a sequential basis is almost flat. So you said product mix improvement so where to look on that aspect?

Gopal Mahadevan: It is like that could be that 39-tonner truck and that could be 15-tonner truck and there could be a bus. When you do that it actually will not help you to gain much insight into it, while I appreciate the analysis that you have done, but believe me, predominantly our margins in this quarter have been better for each of the businesses and each of the product segments.

Basudev Banerjee: Thank you.

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

Binay Singh: Congratulations for a good set of quarter. My question is two questions on the quarter. Firstly, we have seen interest cost drop sharply on a quarter-on-quarter basis despite debt being up, which is a Q1 phenomena. Is this sustainable?

Gopal Mahadevan: You are talking about the debt?

Binay Singh: Sir, like the interest cost in the P&L has gone down sharply on a quarter-on-quarter basis.

Gopal Mahadevan: Let us see, we hope it is because there has been a sharp reduction in debt also, if you were to look at it, because when you look at it, what shall we say, the debt has come down to about Rs.1600 Crores in this quarter and so that has resulted in the overall number of interest coming down. If you look at the same number in Q1 of FY2016, this number was about Rs.3500 Crores. So there has been a reduction in debt and that has helped us to reduce the interest cost.

The second one is interest rates are also coming down. See, basically what I would leave a thought with you is, one is to look at quarter-on-quarter, which is not incorrect because everybody reports results, so one will look at it. Directionally, I think I would like you to look at what Ashok Leyland has been doing. In fact, three years ago, we had debt equity over 2.25 or 2.4:1, depending on the months when I shared the information.

Now today, I am looking at 0.25:1 or 0.3:1. So there has been a huge reduction in debt that has happened through business generating profits. The second one has been a conscious and I would say a methodical effort to reduce working capital and the third one, of course, we did bite the bullet in terms of selling non-core assets, which we have stopped now, I mean, we do not need to do that.

So we have got our debt levels to a very comfortable level. So even between Q1 of last year and Q1 of this year, if you were to look at it, you should recognize that there has been a significant step down in terms of debt and that is the reason why we have got it.

Now am I saying that I will have the interest cost, you know that whatever numbers that we have given will be multiplied by 4, I cannot because there would be a quarter where I may pre-produce and keep it. It is possible that in Q3, my working capital can go up, because I may pre-produce for the fourth quarter.

But then what I would request the analyst community and the investor community to look at it, how is this Company going directionally? How is it going in terms of debt, how is it going in terms of cash, how is it going in terms of market share, how is it going in terms of margins?

So to answer your question, I thought I would take this opportunity to share what we are doing in the company because this is not just about discounting or price increases; this is about driving operational efficiency in the company. Now that is being done through a whole bunch of efforts right from a large team working on material costs to another working on administration overheads, to another working on working capital, to the fourth one even looking at internal processes that may not be required, because as we grow faster we need to have processes, which are faster. There is another fifth team that is looking on complete automation between the customer and the Company. There is a sixth team that is working on the vendor relationship with the Company.

So I see that the efforts of all this that we see in our quarterly result is a confluence, I mean the outcome that we see in the quarterly results is a confluence of all these factors.

Binay Singh: Sir, the YOY bit was very clear. It was not sequentially that surprised me, the debt had slightly gone up while the interest cost went down. So that seemed very impressive?

Gopal Mahadevan: No, that is because you see what has happened is, it is a factor of the working capital and this absolute debt is a month-end number, does not help because interest is accrued every day. So it can happen that in quarter end I have had a slightly higher amount of debt or slightly higher amount of working capital. We must remember in the fourth quarter, we had a negative working capital. Now why did that happen because we had a huge amount of collections that was happening because I repeat, we do not push stock into the market. There is zero credit on my truck business to dealers. So we had this huge amount of money coming in the fourth quarter, which actually resulted in my working capital become negative. This quarter my operating working capital, which is my plain receivables plus inventory minus payables, if I were to look at it, was about seven days or so. So at the month end, when you see that the absolute debt slightly notches up, but my overall debt levels from opening to closing has been much, much lower than what it was in Q1 last year.

Binay Singh: Thank you.

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

Chirag Shah: Thanks for the opportunity. Sir, two housekeeping questions; the tax rate is at 30%, any specific reason and how to look at that number and similarly other income. So is it more of this, what we call the new requirement and that is because of the jump that has happened or is there anything else in that?

Gopal Mahadevan: What did you say the third one was?

Chirag Shah: First, was the tax rate and other income is the IND AS accounting has led to a jump in other income and this is the normal rate that we should look at. That is the first housekeeping question I have on tax rate and other income?

Gopal Mahadevan: Tax rate has been about 30%, I think that is factoring in the deferred tax and whatever tax credit that we have on the R&D spending and all that. So I do not think that we will swing differently on the tax rate. As far as other income is concerned, I will ask Balaji to answer that question. You wanted to understand what the other income was??

Chirag Shah: Yes, the jump is only because of this new requirement of accounting FMP income or there is something else over there?

K.M. Balaji: There is also something else, Chirag, in fact there is also being interest income on account of the surplus cash balances, which we have been carrying throughout the quarter.

Chirag Shah: Sir Question on the gross margins front. So you indicated that you intend to pass on the raw material cost pressures and some action has been taken. Is it right to assume the pressures are already visible in Q1 or though pressures on the commodity side and the conversion cost side would start hitting us from Q2 onwards?

Gopal Mahadevan: Yes. I tell you. I wanted to actually use this opportunity since you asked about IGAAP and Ind AS accounting and I thought I should share that at the beginning, I missed. I wanted the investing community to know and we have tried to display that effectively as possible in our published results also. We have this item, which is exchange gain or loss on swap contracts, I wanted to draw your attention, which is about Rs.49.67 Crores in the current quarter, which comes as an income and which is shown as Rs.18.04 Crores as an expenditure in the previous quarter. This is, Chirag, I am using your sweet time, of course, to answer this question, but I mean, to kind of highlight this point, I just wanted everybody to know that this is a thing that will keep swinging quarter-on-quarter, because this is nothing, but the mark-to-market or unrealized gain or loss on the Japanese Yen to US dollar, because we normally take US dollar to Rupee, but since the underlying was the Japanese Yen, the Ind AS accounting states that we need to actually book this in the P&L.

Earlier this used to come in hedged reserve, but all of this has now moved to the P&L. So what we have decided to do was instead of just putting it in other income and other expenses, which the investing community may mistake it as some windfall or some repetitive income or gain. I wanted to share with you that depending on how the Yen LIBOR rate is going, this number will keep oscillating, it can go positive, it can go negative, but there is no cash out on this. I just thought I would highlight this for everyone's benefit.

Now coming to your point about other income. I think Balaji has clarified, with respect to the margins, all I would want to say is like this. I am just sharing what we do in the Company. We look at each of the businesses, each of the sub-segments. We see what is the pricing that is there in the market, what are the costs that we are having, how is our material cost moving. We must understand that there is only one aspect that increases in material costs. The other part of it is the operational efficiencies that we can get in manufacturing as well as kind of redoing the bills of material and optimizing the overall material in a product. So when we do that, then we see how the margin is. And if we find that there is margin depletion, we try to increase the prices to ensure that we are able to maintain if not enhance the margins. That is exactly what happens in the Company, of course. What discounting that the market has, some of the market has discounting less volume then at some point in time, and you may be constraint in offering certain discounts. But we have to catch up in some other business. So overall, I need to ensure that the truck business is showing better margins, the bus business is showing better margins and within the truck business itself if we are able to get some of the sub-segments should show improved margins that is even better.

Chirag Shah: No Sir, my question was are we already seeing a rise in commodity costs in the P&L or it is likely to happen from Q2 onwards?

Gopal Mahadevan: I think we are already seeing some rise in material costs in the P&L in Q1. If they rise further, then we will see that in Q2 and not at the moment, we are, of course, discussing with vendors. Steel is one of the most important raw materials as the government has got this steel price duty up also. So if the steel prices do go upward, then we would see an impact. So we will have to see ways and means to ensure that we are able to neutralize the effect of the steel price hike as much as possible.

Chirag Shah: Yes, and if I can just squeeze in one question on Pantnagar, so any thoughts of how much we are looking to ramp up the capacity at Pantnagar, we did around, if I look at Q4, we did around 67,000, 68,000 annualized production. So any thought of taking it ahead over there from Pantnagar, or 75,000, that is our peak capacity at Pantnagar?

Gopal Mahadevan: No, we have not. Actually we keep, you should have seen, what we are doing is we are doing some debottlenecking in Pantnagar and we will try to grow the volumes more, but there is no significant chunk. See, I will be making capex in Pantnagar or in Ennore or in Hosur, I am not saying I am not going to spend money. But it is not something that, it is going to be around Rs.400 Crores, Rs.500

Crores capex that we are going to do. That will be debottlenecking and debalancing excess of manufacturing that we will have to do and we are doing that. We keep shifting also and optimizing capacity between Pantnagar and Ennore and Hosur, to ensure that we are able to use our capacity very effectively. So at the moment, our answer is that, I am not going to do any major investments at Pantnagar.

Chirag Shah: But where can the capacity go up, I am aware that you are not going to put great money in Pantnagar, but have it hit the peak capacity or there is still room to expand by 10%, 15% over there?

Gopal Mahadevan: I cannot share that information, but there is capacity for it to expand.

Chirag Shah: Thank you very much Sir.

Moderator: Thank you. The next question is from the line of Sanjay Doshi from Reliance Mutual Fund. Please go ahead.

Sanjay Doshi: Good morning Sir and congrats on a good set of numbers. Just wanted to carry forward the earlier question, you mentioned about commodity pressures in quarter one, can you quantify that for us, what could be average cost increases?

Gopal Mahadevan: Yes, I would, instead of quantifying it, I would say that I think the commodity pressure would have been above 0.2%, 0.3% of revenues, even little lesser than that, because what has happened is, the only impact that has happened is on the steel price. There are negotiations going on with all suppliers in the entire industry, it is not particular to Ashok Leyland, , the entire industry is having to do that because we have to discuss with our suppliers as to what is the kind of increases that has to happen. So we do expect that the commodity prices will go up, but then you see we cannot just sit and wait for commodity prices to go up. We have to plan in advance and that is exactly why I took a larger kind of canvas to explain what is happening within the company. Yes, commodity prices, if they shoot up the roof then of course it a completely different issue, but is it going to materially impinge my margins significantly at the moment my visibility says no. I am very clear about that because we are looking at a strategy to ensure that if the commodity prices happen, we would like to pass it on to the customer and we will wait and watch in quarter two and see how the margins look like.

Sanjay Doshi: Great. The other thing I just wanted to get your thoughts on the tipper segment, you mentioned earlier in the call that you have seen almost doubling of volume in the tipper segment. Can you put that in perspective of the industry and your market share because I mean this could be a much sharper growth segment this year?

Gopal Mahadevan: I would love to share the market share, but I cannot because we do not do that in sub-segment level. In fact, we do not share too much of market share details, because internally when we are trying to grow the Company and move it forward, what we decided, the senior leadership team, of course, led

by Mr. Vinod Dasari, our MD, is to, look at how are we growing. One is to say, not only how much are we growing, but how are we growing that is also important and the second part of it where are we growing. So I need to look at the market and say okay the market has grown by X%. Am I growing at X% or not, that is like a thermometer. I need to have that thermometer and as long as I am doing better than market it is good. Yes. Last year we grew at 50% when the market grew at 30%. It was very exciting for us. It is not that we will not say that we do not want to grow at that pace, but the more important thing, how am I growing. Am I introducing the most current products, am I offering services, is the component of services business also getting better in my overall revenue pack? Am I growing geographically in India on a Pan India basis? Is my East segment growing or not, which was today plus 20%, 21%, 22%, three years back it was less than 10%? So, how is my presence being felt and then after that is the growth between my domestic and my exports? Am I putting in all the building blocks to ensure that my export growth is going to happen? So when we look at all of this, the market share is one piece of it, which is important, I am not saying it is not important. So what have you done this quarter, my market share has moved from 30% to 31%. Okay. And if you look at it there has been growth equitably in bus and in truck. We have had this offer, I mean, this orders of nearly 3600 buses from various STUs, which will, when I start rolling it out, my market share will improve but what we are looking at is am I keeping pace, am I running at a faster pace than the market in terms of growth? Am I also growing profitably? That is what we look at, so for me to say this tipper market, market share has improved, month-on-month and quarter-on-quarter I know the industry reacts with the stock prices going up and down like this. Internally, we always wonder why are they doing this because we respect the market, we respect all the analyst community, who have been supporting us over the past so many years, each one of you who are in the call, I am thankful that you are showing the interest in Ashok Leyland but at the same time, getting the market shares on a month-on-month basis does not really signify anything.

Sanjay Doshi: Many thanks Sir and all the best.

Moderator: Thank you. The next question is from the line of Srinath Krishnan from Sundaram Mutual Fund. Please go ahead.

Srinath Krishnan: Thank you Sir and good morning. Sir there is a Company named Ashok Leyland Defense Systems where you have 26% stake? Can you highlight what is the role of this Company? And the second question is on Power Solutions business where you have in your annual report mentioned that there is an updated strategic roadmap for this Company. What would this strategic roadmap be for this segment?

Gopal Mahadevan: Yes, as far the Ashok Leyland Defense System is concerned; it is a step down of Ashok Leyland where Ashok Leyland holds I think 26%. The basic idea is that we have to make certain defense supplies through this Company. There is an arrangement between Ashok Leyland and Ashok Leyland

Defense Systems. The operations currently are very small but we plan to grow this Company as we move forward. What was your second question?

Srinath Krishnan: Who holds the rest of the stake?

Gopal Mahadevan: It is held by other investors at the moment, which I would not want to discuss, the stake holding is actually done for a strategic purpose.

Srinath Krishnan: The second question is on Power Solutions business where your annual report mentioned there is a strategic roadmap here and growth last year was around 10%, 11%. So what is that?

Gopal Mahadevan: See our Power Solutions business, it roughly constitutes about 2% to 3% and it has been flattish because the power sector, this essentially does use our engines. We are and am not trying to be overconfident here, in all humility let me tell you that, we manufacture some of the best engines in the country today not only for vehicles but also for diesel power equipment. What we do is, we actually supply these engines and these are used for manufacture of diesel engines. We, of course, on a much lesser scale also are one of the largest providers of engines for fishing boats. But anyway, this business has actually scaled up by more than 10 times over the last, I would say till about two, three years ago and after that it has been reasonably flattish because power sector has been also, you know, the peak demand, the peak deficit which was there possibly at about 14%, 15% has come down drastically to single-digit numbers. So the requirement for gensets has not been really growing due to which this business has been kind of flattish but extremely profitable.

Srinath Krishnan: Last question Sir, this assembly unit in Bangladesh and Africa. So would that entail capex in next two years?

Gopal Mahadevan: The first one, no in Bangladesh, because that is being done by our strategic partner. As far as Kenya is concerned, yes, it will require investment but initially it will be a very small investment between $5 million to $6 million. Go up to about $10 million because the assembly units are not very capital intensive but the multiplier effect actually comes in when you actually ship kits and assemble the kits locally, where is the multiplier effect, first of all, you do not end up shipping air. You actually ship the kits and assemble the vehicles there. The second most important thing is that you are actually very close to the end customer community because the government, the people, you provide local employment, the visibility gets better and that is why we said that we will set up the assembly facility there, we will start with a assembly facility in Kenya.

Srinath Krishnan: Thank you.

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

Pramod Kumar: Thanks a lot. Good morning Gopal and congratulations on a good set of results. Gopal, my question pertains to the industry, I just want to understand based on the GST because you have talked positively about it, everyone is positive on the GST impact. I just wanted to understand in the first phase where the GST gets implemented when most of the state level checks of trucks and all the toll nakas go away. How much of capacity do you expect the industry to free up? Because speaking to fleet owners, there is a wide range like anywhere between 10% and 15% of the fleet at any given point of time is stuck on the borders, in the kilometer long queues. So I just wanted to understand what is your thinking because you will have a far better data on this? If you can answer that, that will be really helpful.

Gopal Mahadevan: See first of all, I think the GST when I say it is a positive impact is because the entire economy, the industry is looking at a positive effect from GST and that is not coming because of the removal of toll nakas. The positive impact of GST is going to happen, because what is going to happen is, there is going to be seamless movement of good and services between states and the end customer will also get benefited from this effective and rationalization of tax rates. If that happens, we are going to see a positive effect in the economy, which will very clearly trickle down to the commercial vehicle industry because we will have to move more goods as an outcome. As far as the toll nakas is concerned and the queues are concerned, while your point is pertinent, I would want to see all of this happening and thus release of capacity. Because at the moment, we are not actually saying that if GST comes, the capacity utilization of fleet will go up by 10% or 15%, because we really do not know how this mechanism is going to be monitored, because we must understand there are states and between states there are borders. So how is the government going to monitor this? We will have to wait and watch, what we are positive is that may be long queues will start coming down, if they start coming down actually what can happen is when you have a more efficient system of transportation, then the ROI on that business goes up and actually that can be a kicker for further investments and there are other positives that will happen also. When road transport becomes more and more efficient then what is going to happen is that more people will start investing into trucks because they become more profitable, rates may come down, but the overall deployment and leverage that you get is going to be better. The second one is, the industry is also going to, if the government were to move towards rated load. Yes, there will be a rate rationalization, but then what happens is more trucks will be deployed and the fleet operator, the economics will change from getting more margins from first truck to getting better profits on a capital employed with a larger number of trucks. So they will also have the whole and so we are going to see, I would say a more logical outcome for the industry. So I am very positive about the GST outcome.

Pramod Kumar: No, that point is well taken Gopal; everyone shares the optimism the only thing is because of the capacity getting freed up or the bottlenecks going away there could be a one-time adjustment for demand to happen in the end?

Gopal Mahadevan: I do not think it is going to be material it is not going to affect our profit.

Pramod Kumar: So in a way you are saying that very few trucks are either way getting stacked that way. So there is not much to be expected when it reverses?

Gopal Mahadevan: I do not think fortunes are going to hinge on that that is a very minor point.

Pramod Kumar: And on the scrappage, Gopal, because there is a lot of us talk about whether it is going to be voluntary/mandatory, what is your thinking on this broadly as a Company and whether you are a believer or you are demanding that there should be a mandatory scrappage of the older trucks? What is your thinking there?

Gopal Mahadevan: We are not demanding anything, I think it is up to the government to decide how it wants to the Government Green Tribunal and all the other authorities as they how they want to manage or control the pollution. It is not trucks, which are actually doing the pollution by the way because all the trucks that are running today are reasonably certified. I mean all of them are certified as per the emission norms but, yes, if the emission norms are getting better, the industry should get into better norms and if that happens, it is going to augur well for the industry because the replacement demand will kick in but what the government will also we have to look at it, how are we going to scrap these vehicles for which there is not much clarity, but I am sure they will come out with a plan.

Pramod Kumar: And finally, FY2017 do you expect outgrow the industry just like how you did for last year, which is phenomenal?

Gopal Mahadevan: I did not understand what you said?

Pramod Kumar: FY2017 do you expect to outperform the industry growth like in the last two years?

Gopal Mahadevan: I do not want to give an outlook. I only give what we want to do. We would certainly like to outperform the industry. But we would also want to grow profitably. We would want to reduce our debt levels. We want to ensure that the operating leverage kicks in. What I do, the only important thing about quarter-on-quarter results is, sometimes we also use it as a measurement to pause and see where we are. So, I am happy to state that over the last nine quarters, straight nine quarters, we have been outperforming the industry domestically. And it is our aspiration to make it to the 10th and the 11th and the 12th quarter, but let us wait and watch. See, these are things one cannot say, but all I can say is that, that is how the Company's aspirations are.

Pramod Kumar: Thanks a lot and thank you.

Moderator: Thank you. The next question is from the line of Aditya Ahluwalia from Invesco. Please go ahead.

Aditya Ahluwalia: Thanks for taking the question. You guided for 15% to 20% FY2017 growth in the previous call, is that the same number you mentioned this call?

Gopal Mahadevan: Yes. 15% to 20% is what we told at the beginning and that is what I am holding onto at the now. I do not know, but that does not make me a good soothsayer, but the first quarter was almost 15%, it was 14.5%.

Aditya Ahluwalia: You talked about pre-buying having an impact in the second half, all that still remains?

Gopal Mahadevan: Yes, absolutely.

Aditya Ahluwalia: You take a 1% to 1.25% price increase every quarter?

Gopal Mahadevan: You see I want to share something because I know that all of us are discussing about what the numbers are going to be. You have a visibility, so has the Company, but if you really sit back and look at it, it is a little bit. The condition of the economy seems to be a little better than what it was six months ago. The rain seems to be reasonably on track, the monsoon seems to be reasonably on track. The investment-led strategy of the government seems more visible today. We are seeing that road sector is; see one-year back, there was no visibility on any sector. Today, we are seeing that the road sector is doing well. We are saying that the mining is going to be opened up. Infrastructure seems to be also looking positive, that is why transport companies also seem to be doing well now in at least the stock markets. Today, we have seen S&P saying that the economy is re-rated to 8%. So see, we also are depending a lot on we are also looking into the future. We do not have the future and discount it and tell it as at the present. So, when we make assumptions, when we make manufacturing planning, when we make other plans also, we are relying on certain key indicators and at the moment, the key indicators seem to be auguring well. And that is why; it appears that 15% to 20% seems more positive today than it was at the beginning of the year. Hopefully, this traction will continue and we would see that through in the full year, if that happens, that is good for all of us.

Aditya Ahluwalia: Can you just tell me what will be the cost impact because of these emission norms coming in at the end of the year?

Gopal Mahadevan: I think the cost impact for emission norms could be anywhere around Rs. 75000/- a vehicle depending on the vehicle. It could even be higher, but the point is that this would obviously get passed on to the customer because they are buying a totally different vehicle.

Aditya Ahluwalia: The commodity prices in general are going up and you are taking price hikes to neutralize that?

Gopal Mahadevan: That is what we have been doing so successfully enough to now. Hopefully, we will be able to do that in future too. We have to, and it is not just price hike, if my price goes up by X%, I do not do immediately X-plus margin percent into my customer. I have to rationalize my portfolio. I will have to add value and drive the pricing. We of course try to drive the pricing through the entire portfolio then we look at geography. More importantly, we look at operational efficiencies. We look at engineering design. How do I optimize the cost of the product? Things can only be done better. We

believe in that. So we keep continuously working on this, because it is important to us. Ultimately, what happens is demand and supply actually determines the pricing. After that, we have to ensure that between what can be offered by the customer and what costs at the Company level, we have to ensure that that trend continues to grow and that is exactly what we are trying to do and we have been doing.

Aditya Ahluwalia: And just one last question. Last call, we were talking about and we indicated very aggressive competition, is that also the same now, the competitive intensity in the market or is it getting slightly better?

Gopal Mahadevan: I can only say that there is competition and there are different strategies that every player adopts. We believe in growing our network. We believe in giving offerings to customers. We believe in giving better offering to customers and at more efficient cost and we also try to also drive the margins in the bargain. That is how we are trying to do the business. Yes, I mean, the intensity is there. Still, I think, this is no longer the market that it was 10 years ago where it was only one, two or three companies. Today, we have multiple players and multiple aspirations and multiple means of achieving their goals.

Aditya Ahluwalia: So, it is the same as what was no change there?

Gopal Mahadevan: It is not changed. I do not think so.

Aditya Ahluwalia: Thanks a lot.

Moderator: Thank you. The next question is from the line of Dinesh N from Catamaran. Please go ahead.

Dinesh N: Thanks for taking my question. I have two questions. One is of the trucks, which we sold this quarter, how much percentage would be BS-IV compliant and how much would be BS-III compliant?

Gopal Mahadevan: I do not have the number readily.

Dinesh N: Now they have ABS fitted with them. Am I correct in that assumption? These are my two questions, Sir?

Gopal Mahadevan: No. The first one was about BS-III, BS-IV. I would say what you have asked was the ratio, I do not have that ratio readily, but it is not a very significant number. I think the traction will start building in the later part of the year.

Dinesh N: So, if it is not significant number, then can I assume more than 90% would be BS-III only right now?

Gopal Mahadevan: I think Balaji can share that number offline a little later, but I do not have that at readily, but yes, I would say that, yes.

Dinesh N: Okay and about the ABS all the trucks and buses, which you are selling right now, are fitted with ABS Sir?

Gopal Mahadevan: Yes.

Dinesh N: Okay and what would be the price difference between a truck fitted with an ABS and a truck without ABS, which was done last year?

Gopal Mahadevan: It is going to depend. An ABS can cost anywhere between Rs.20000, Rs.22000 to about Rs.40000, Rs.45000. So it depends on the thing. Cost is, ultimately what matters is what the customer can bear.

Dinesh N: So that cost has been completely passed on to the customer?

Gopal Mahadevan: Yes.

Dinesh N: Okay and if the BS-VI norms come up, then do you have some - what would be the cost difference between a BS-IV and BS-VI? Do you have some kind number on that?

Gopal Mahadevan: At the moment, I cannot hazard a guess; because you see what happens is BS-VI is like a completely different technology all together. First of all, we should have the fuel for it. The particulate matters and NOx emission etc. are completely different. But I can only tell you one thing. We possibly are one of the few companies who have got this technology ready, because in BS-VI, you would need to have not only ECR, you need to have what is called as Selective Catalytic Reduction also, SCR technology. We have the technology, we are already supplying to global automobile manufacturers there. That is a company that has just started and for us, we would use that technology to provide the solutions in India as well. Our Neptune engine is scalable to BS-VI and we have displayed that in the Auto Expo also. It was a running Neptune engine. It was not just something that was just displayed. That provided of course we have to work out the cost, we have to get it better and better, but we have our own BS-VI roadmap.

Dinesh N: Thanks for taking my question sir, all the best.

Moderator: Thank you. The next question is from the line of Mihir Jhaveri from Religare Capital. Please go ahead.

Mihir Jhaveri: Congratulations on a good set of numbers. Most of the questions, answered. Just quickly, sir, what would be the inventory level currently in the system prior to dealer level if you can help or from at the company level as well?

Gopal Mahadevan: Ourselves we are at about 8,500 units as on the end of the quarter.

Mihir Jhaveri: In the quarter and we have seen that the fleet rates have moderated over the last month. So just wanted to ask you in the short term, in terms of July, how is the numbers looking like? And secondly, the second question is what is the pipeline of product launches if you can reiterate that, sorry if I missed that, but what would be the product launches in the coming quarters, if you can just?

Gopal Mahadevan: We do not do a big bang pan-India launch, we never did that with BOSS, and we never did that with Captain. In fact, we still have launches of Captain in the higher tonnage to be rolled out. In fact, we also have the BOSS AMC to do it, because what we do not do is, we launch and then we take customer inputs and then we keep kind of doing in city-by-city or state-by-state. Having said that we have two exciting launches, one is, of course, the Sunshine which is absolutely state-of-the-art India's first roll-over protected, front-impact protected school bus, designed for children, pretty well accepted by schools, and we are going to see the benefit of it coming in the next school season, which will start in January. Of course, we have started this, we just started pre-sales of it on a test basis, because then you can get inputs. The second one is, of course, a vehicle called Guru. It is again on the ICV space. It is going to kind of complement the BOSS, and BOSS is the premium end vehicle whereas this one is, it is a rated load vehicle and very pertinent to for the end-use application. What we are trying to do is actually deliver vehicles, which are required for specific applications also. When you require, the vehicle that you require, I do not want to get into details, because we are running short of time, but a vehicle required for transporting FMCG goods is not the same that is required for transporting charcoal. These are completely different, even for short-hauls. These are completely different vehicles. So, why it is given over-expectations, so we are trying to actually kind of cut the entire portfolio into reasonable sizes, which will address customers' requirement, which is what I mentioned. It is not about this growth. We are trying to also see, how can we grow, what is the, I would say, fragment of our growth. I mean, how are we doing that? That is important. So these two vehicles we believe are going to be very, very positive for our ICV's growth strategy, and Guru is not yet launched, that will happen very shortly, maybe in a couple of months' time.

Mihir Jhaveri: Sir, if you can tell me how the short-term, how July is looking like given that the freight rates have gone moderated, so if you can throw some light how is the demand scenario?

Gopal Mahadevan: Have to wait and watch, because while freight rates have moderated, we will have to look at what the growth for Q2 will be. I believe Q3 maybe a tad soft, but again Q4 should pick up. I think the entire industry is looking more at Q4, but I expect Q2 also to grow but let us see, there is a base effect. But at the moment, at least from the feel that we have on the first 20 days of July, which is the new quarter, we have not seen anything negative coming back. If there is anything, we rest assured that as a company we keep sharing what we believe on the perception based on what we have. So I would not want to be overtly optimistic, I do not want to be overtly pessimistic, I do not want to sound over-confident, I do not want to sound under-confident, I want to be as realistic as possible and as while driving in a road, as the road keeps unfolding, we share our perspectives with you and that is what we

are doing. So at the moment, I do not see anything lagging in Q2. We expect that to also grow, let us see.

Mihir Jhaveri: Thank you Sir and all the best.

Moderator: Thank you. The next question is from the line of Hitesh Goel from Kotak Securities.

Hitesh Goel: Thank you Gopal. Very good set of results. Just two, three questions. One is Ind AS, I was looking at Ind AS numbers for Q1 FY2015, your topline in Ind AS versus Indian GAAP is higher by Rs.42 Crores and your other expenses is also higher. Can you please explain that?

Gopal Mahadevan: Balaji, would you want to take that?

K.M. Balaji: Yes. Actually, some of the recoveries, which we have made towards vehicle transportation charges earlier, it used to be shown in the other expenses. Now, the recovery portion of it goes to the revenue side and the charge portion of it retained in other expenses, that is where you will see the difference. Rs.42 Crores, earlier you would have got netted in the other expenses. Now, this recovery will be reflected in revenue and expense will also be higher to that extent.

Hitesh Goel: So this is related to the freight expenses?

K.M. Balaji: Yes.

Hitesh Goel: Sir, have you taken any price hike in July month?

Gopal Mahadevan: I think we are planning to increase. Some parts we have already increased about a 1% but that is what we are doing.

Hitesh Goel: You have taken a price hike or you are planning to take one?

Gopal Mahadevan: Yes, price hike in some models in the portfolio.

Hitesh Goel: My final question is on the gross margin side. Sir, I was looking at your historical gross margins. In Q1, your gross margins actually are the best and then they decline going forward, but operating leverage plays out because your volumes are much higher. So that is the trend we look at. Is there anything in Q1 that you give the vendor increases later in the year, anything to read on this trend?

Gopal Mahadevan: Like I told you, there have been certain price hikes that have come in Q1. We are still in negotiations with the vendors for any further price hikes that is happened in Q2, because material prices are hardening. If they are going to happen, then we will have to take, but we are in negotiation. I am not able to get the visibility of what the price hikes are going to be. All I can tell you are that, our price

hikes are in tandem with the market, if not a little lower. So they are also seeing larger share of business coming from us. The quality of payment that we do to our vendors is significantly better than what it used to be three years ago. We are absolutely spot on. So they see the quality of relationship also as overall thing. The entire vendor management is not just about pricing it is about managing relationships. So sometimes, we are able to get better deals. But if there is a price hike, yes, we will have to translate it and hopefully, we are also able to pass it on to the market and retain our margins.

Hitesh Goel: Thank you Gopal.

Moderator: Thank you. Ladies and gentlemen that was the last question for today. I would now like to hand over the floor to Mr. Deepak Jain for his closing comments. Over to you Sir!

Deepak Jain: Thank you everybody for being on the conference call. Thank you, Mr. Mahadevan and Mr. Balaji for taking time out for this.

Gopal Mahadevan: Thank you very much. Thank you all for the interest in Ashok Leyland. Thank you.

Deepak Jain: Have a nice day Sir. Thank you.

Moderator: Thank you very much, all. Ladies and gentlemen, on behalf of IDFC Securities Limited that concludes this conference call. Thank you for joining us. You may disconnect your lines.