"Ashok Leyland Limited
Q3 FY '23 Earnings Conference Call"
February 02, 2023

MANAGEMENT: **MR. DHEERAJ HINDUJA – EXECUTIVE CHAIRMAN – ASHOK LEYLAND LIMITED**
MR. SHENU AGARWAL – MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER – ASHOK LEYLAND LIMITED
MR. GOPAL MAHADEVAN – DIRECTOR AND CHIEF FINANCIAL OFFICER – ASHOK LEYLAND LIMITED

MODERATOR: **MR. NISHIT JALAN - AXIS CAPITAL LIMITED**

Moderator: Ladies and gentlemen, good day, and welcome to the Ashok Leyland Q3 FY '23 Conference Call hosted by Axis Capital Limited. As a reminder, all participant lines will be in the listen-only mode and there will be opportunity for you to ask question after the presentation concludes. Should you need assistance during the conference call, please signal the Moderator by pressing star then zero on your touch tone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Nishit Jalan. Thank you, and over to you.

Nishit Jalan: Thank you. Good afternoon, everyone. Welcome to Q3 FY '23 post results conference call of Ashok Leyland. From the management team, we have with us Mr. Dheeraj Hinduja, Executive Chairman; Mr. Shenu Agarwal, Managing Director and Chief Executive Officer; and Mr. Gopal Mahadevan, Director and Chief Financial Officer. I'll now hand over the call to Mr. Hinduja for his opening remarks, post which we can move to Q&A. Over to you, Mr. Hinduja.

Dheeraj Hinduja: Thank you. Good afternoon, ladies and gentlemen. It gives me immense pleasure to be in touch with you, and I thank you very much for the interest shown in Ashok Leyland. I will quickly run you through the Q3 performance as well as some of the latest developments.

I'm extremely happy to share that Q3 FY '23 continues to be good, aided by strong performance in domestic truck sales with 32.6% market share. This is almost a 7.3% increase over our market share during the same period last year. This is the fourth consecutive quarter of 30%-plus market share for Ashok Leyland.

In Q3, MHCV truck volumes have grown more than 1.3 times than the industry growth, resulting in AL market share improving to 32.6% as compared to 25.3% in Q3 of last year.

EBITDA for Q3 was at Rs 797 crores, 8.8% as against Rs 224 crores, 4% in Q3 of last year.

Our LCV volumes in Q3 are higher than last year by 15%.

Q3 domestic after-market sales at Rs 507 crores grew at 28% over the same period of last year.

Q3 operating profit was at Rs 560 crores as against a loss of Rs 15 crores in Q3 of last year.

Working capital has reduced by about Rs 135 crores during the quarter. Capital expenditure for the quarter was at around Rs 100 crores. Our profit during the quarter has helped with the reduction of net debt by about Rs 635 crores. Debt equity is at 0.3 times versus 0.4 times during the same period last year.

During the quarter, we have launched Partner Super in 9, 10 and 11 tons, Oyster Wide CNG, Oyster Wide Diesel double door, 13.5-meter bus with drum brakes, Lynx Smart Staff bus chassis and expanding our range further with new products.

I'm extremely confident that with these launches and the continued expansion of the network, we will sustain the market share gains achieved in the last 4 quarters.

The growth in MHCV trucks TIV in Q3 and LCV truck is backed by recovery in macroeconomic environment, replacement demand and pickup in infrastructure, mining and construction activities. Healthy growth in the end-user industries like cement, steel and infrastructure as well as increase in general manufacturing activity and consumption trends continue to support demand from fleet operators. Supported by these factors, the industry volumes are inching towards the previous peak registered in FY '19.

The viability of fleet operators is expected to continue to remain healthy despite some moderation in freight rates post the festive season.

For FY '23, the industry volumes are expected to grow at a healthy rate, supported by steady freight demand and economic recovery, the government's focus on infrastructure spending and boom in e-commerce. However, inflation concerns driven by hike in interest rates and continued high fuel prices and its impact on viability of fleet operators would have to be monitored in the near future.

We are very encouraged by the resumption in the MHCV passenger segment, which reported a year-on-year growth of 132%, supported by almost full resumption of offices and educational institutions. However, the volumes are yet to reach the pre-pandemic level of 10,000 to 12,000 per quarter.

LCV year-on-year growth of 5% is supported by healthy demand from agriculture and allied sectors, the increased last-mile transportation requirements especially from e-commerce and stable macroeconomic environment. While the pace of growth is slowing down as the base effect catches up, the volumes have already surpassed the quarterly level reported in FY 2018 and FY 2020 level and are close to industry high seen in FY 2019. The softening of commodity prices, in particular steel, has impacted on the margin positively.

Ashok Leyland, even while growing market share sequentially has been raising prices owing to higher input costs. What is good to see is that the retention of such increases is better.

LCV, both Dost and Bada Dost, are gaining in road and had been growing stronger by the day. Both these products hold immense potential for exports and are a perfect fit in our addressable market.

Aftermarket also continues to perform very well.

We are putting tremendous efforts in reducing costs, both product costs as well as overheads.

I know there has been a lot of interest in Switch, which is an important initiative, and we are committed to developing Switch with global electric vehicle company. We have established a name and a platform as a credible EV manufacturer. Our sales order pipeline is robust. We are chalking out our plans to utilize growth opportunities fully by chasing high-quality, cost-effective products.

After I finish, I will ask Gopal to brief you further on the results at Switch and the status with potential investors. Finally, before I open the floor to questions, let me share the financials in brief.

Revenue for Q3 at Rs 9,030 crores, which is 63% higher than Q3 of last year. Manpower cost in Q3 is higher than previous quarter by Rs 22 crores, due to variable performance pay and bonus provision restatements reflecting the current performance level.

EBITDA is at Rs 797 crores, 8.8% in Q3, up from Rs 224 crores last year. Profit after tax after exceptional items for the quarter was at Rs 361 crores versus Rs 6 crores in Q3 of FY '22. Operating working capital for Q3 was at Rs 355 crores as against Rs 490 crores as of

September '22. Net debt was at Rs 2,043 crores in December '22 as against Rs 2,677 crores in September 2022.

Debt equity at the end of the quarter was at 0.3x. Capital expenditure for the quarter was at Rs 104 crores. Cumulative spend till December 31, 2022, was at Rs 322 crores. Capex spend for the full year is estimated to be up around Rs 600 crores.

So, before we open the floor for questions, I would request Gopal to brief you a little more on Switch.

Gopal Mahadevan: Thank you, Chairman. So good afternoon to all of you. Thank you very much for the interest in Ashok Leyland. Just to quickly brief on Switch. The company is doing very well. All of you must have read about it. The company recently has got a 2,100-bus order from CESL, one of the largest orders which the industry has witnessed. And this has been followed through with another 500-bus order from the Telangana State Road Transport Corporation. Of course, all of this would be final, but some adjustments may happen in the volume when final rollout happens, but it's a very large order, which is material for the company and also for the industry.

We can really see that the potential of EV is growing very fast in India. The company is poised to launch a spectrum of exciting products. I think the double-decker, which was launched last year, the end of last year has created a lot of excitement. It has raised the bar of the industry in terms of quality, fit, finish and total cost of ownership and also the viability of double-decker as a transportation EV alternative.

Switch U.K. is also poised to launch the E1 bus sometime in the early part of next year or later part of this year. The whole industry is waiting for the Bada Dost EV to be launched, which should happen sometime in June or the third quarter of the current year. So, there's a lot of activity on the product development also. We have had order bookings coming in. Switch U.K. is waiting for the European markets to recover.

As you know, there has been a lot of challenge on the European and the U.K. side because of not only the economic turmoil, but also the impact of the war, etc. But we believe that once this happens, we are going to see the potential of Switch U.K. also to scale up very quickly.

Hope you would be keen to understand where we are on the fundraising activity. As we had discussed earlier, it is taking a little bit longer than expected, not because there is the lack of interest from investors into it, but we just want to ensure that we're getting the right strategic partners who will partner Switch and its management team in growth. There are active discussions going on with several investors, both for Switch and for Ohm, which is the e-mobility-as-a-service company that has been structured. And we'll have more to update you maybe in the coming quarter. We will keep you posted, but business is continuing. And I think the leverage that the Switch team has been able to obtain in getting orders on product development is being very much on time. So back to you, Chairman.

Dheeraj Hinduja: Yes. Thank you, Gopal. We will be happy to take your questions now.

Moderator: We have the first question from the line of Jinesh Gandhi from Motilal Oswal.

Jinesh K. Gandhi: Congrats on good set of numbers. Quickly, if you can just talk about the drivers of margin expansion in this quarter? How much would have been contributed by the commodity costs benefits? And is there any reduction in discounts which we are seeing and talk more about it?

Gopal Mahadevan: Okay. Let me take a shot at this. Jinesh, essentially, we have seen a confluence of factors that drive margin expansion. I would say there are 4 reasons for it. And we rightly observed, so we mentioned 2, which are the most important ones or the critical ones.

One is there has been improvement in realization, and we have been consistently raising prices. Over the last few quarters, we have done that even in the month of January, because we believe that with the growing demand, we also need to raise the prices because there has been a shift from BS IV to BS VI. And while metal prices are coming off, which is extremely positive for the industry, we also know that there has been an increase in steel prices, which has happened over the last 2, 3 years. So, we continue to raise prices as efficiently as possible.

The second one is, again, as you mentioned, steel prices have come off quite sharply. And as Chairman had mentioned, our expectation is that they will continue to be at these levels or even a little softer in Q4, which will help in improving margins as we move forward.

The third thing, which has also improved, as I mentioned before, and now I'll explain. The other two are the mix of the products. We've been continuously working on the mix to ensure that the higher profitable models are being sold, and this has helped.

And finally, is the absolute volume itself. We have seen a significant improvement in market share. Just one year back in June / July 2021 or so, our market share was at about 18.5%. We have market share significantly above 30% in the current quarter. And we hope to pursue growth as we move forward. This has been possible because of the exemplary performance of the AVTR range of vehicles.

The modular range of vehicles has been accepted very well in the market, and there's quite a bit of pull in certain segments for AVTR vehicles. And I think in terms of quality, cost, delivery, total cost of ownership, fit and finish, I think AVTR range has proved itself.

The light commercial vehicles have also been doing reasonably well. They have saved some headwinds occasionally, but they are on a growth trajectory. And all of this volume growth has also helped in the operating leverage you can notice.

Jinesh K. Gandhi: Okay. And are we seeing a real moderation in discounts now? I mean, one of the largest player has talked about going towards demand for model. So are we seeing a benefit of that on the ground now?

Gopal Mahadevan: I hope that the industry will, given the fact that this is an unique industry, where it is actually, there's so much of demand which would actually be a seller's market, so to speak, but we've seen that there has been deals we're getting one based on price, which was absolutely not necessary. We are seeing that discount levels are coming off a bit.

We are expecting that we would see a little more consolidation on that in the fourth quarter. Finally, Jinesh, as you know, and to all the other investors also who have joined on the call, what we do at Ashok Leyland is we monitor the net-price realization.

So finally, what matters is what is the net delivered price to the company, and that has been improving month-on-month. We are having a sharper focus on this because it's not enough just to grow, which is very important for us. It is not growth or profitability; it is growth and profitability.

Jinesh K. Gandhi: Okay. That's good to know. Secondly, can you talk about transition towards BS6 Phase-2? How do we plan to transit for that and the kind of price increase we would need to take to pass on the cost?

Gopal Mahadevan: Well, I think the industry is expected to raise prices on OBD2, and different players have got different technologies. So, we would continue to ensure that we are more than covering our costs and recover the same.

The actual kind of numbers on the cost increase, we'll have to wait and watch, like I mentioned, Jinesh, each of the industry players have got different technologies. The only thing that I can say at this moment and while one can't be 100% confident on this, but we are reasonably confident that we are not going to get impacted severely by OBD2.

Jinesh K. Gandhi: Got it. And then last question is on the tax rate. And do we plan to move to new tax regime in FY '24? Or we'll continue with the old tax regime?

Gopal Mahadevan: We'll have to study the finer points and details and then take a call. I think this has been a very good budget, positive for the industry infrastructure and also some rationalization that has happened on the tax structure. But we'll have more to share as our guys, our tax Pandits in the company are going through the finer details. But at this moment, we are not able to share anything else.

Moderator: We have the next question on the line of Kapil Singh from Nomura.

Kapil R. Singh: Congrats on a great set of numbers. My first question is on demand. If you could share your outlook for 2024. You mentioned about some of the positive catalysts as well risks and on the balance do you expect like a double-digit growth next year?

And also, for the OBD2 norms, is the last date 31st March for production? Or this is the last date for registration? And do you expect any element of prebuy?

Gopal Mahadevan: Okay. Dheeraj, do you want to take that one on demand or...

Dheeraj Hinduja: Sure. So, I think we've seen a very strong recovery during this current financial year. And based on all the initiatives that we heard in the budget yesterday and special focus on the capital expenditure and transportation, we do expect that this strong momentum to continue.

In terms of quantifying it, I would say that depending on finally how the GDP growth rates move, our industry is very closely correlated with that. But I think all indications are that it will continue to remain a very strong year next year as well. Yes, Gopal, go ahead.

Gopal Mahadevan: Yes. So, Kapil, on OBD2, we'll have more to share possibly at closer to the end of the quarter, as I mentioned, to Jinesh also because we need to get some clarity overall. But all I can tell you is that we are well positioned in terms of the technology that we are currently offering in OBD that we would be able to kind of seamlessly move forward on that.

Kapil R. Singh: Yes, I know the question was also because we all know prices will go up. We don't know to what extent, but normally, that leads to a prebuy. So that's where the question was coming from.

Gopal Mahadevan: Yes. So, it's a good question. I mean, the only point is, while it is easy to say that yes, because there will be a pre-buy. I don't think that that will be a huge driver in terms of a change.

Like for example, if you notice, in 2019-20, right, which was pre-COVID, the entire industry was expected to have a heavy pre-buy because of the implementation on BS VI on 1st of April. But we saw that quarter-on-quarter in 2019-20, actually, the demand was not going even though the cost of the vehicles was supposed to go up quite significantly.

Of course, unfortunately, after that, we had an immediate Covid outbreak. I think what we're going to see is that if the prices that's going to be raised by the industry is going to be quite material, you could see some amount of prebuy.

The best part of this current year's demand has been that this has been quite a pull from the customers. There is genuine demand on the ground, all industries are doing well. There's a huge amount of infra spend. So, I think even if that continues, that would be this trajectory is sufficient for posting a healthy growth in the current quarter. On top of it, if there is an OBD2 prebuy, well, that's going to be positive. But I don't think we are planning for a material demand base increase because of OBD2, but we'll have to wait and watch.

Kapil R. Singh: And sir, second question is on margins. I just wanted to understand how you think about the evolution of margins from here. So, you can probably throw light upon 3 areas. One is whether you expect further commodity benefit. Second is on pricing. And third is on operating leverage because we are seeing that your other expenditure is not rising as much as the revenue growth now. So, are most of the costs related to say, travel or AMC and all are already there? Or do you expect R&D or other things that are already there in the numbers now? Or do you expect any material increase there? So just how you think about these 3 buckets of costs as we head into next year?

Gopal Mahadevan: I'll possibly give a general view and then possibly request Chairman or Shenu to add. You see what we are doing in the company today is to drive operational efficiency across the company. We have been doing it over the past several years, of course. We have had various programs and material cost reduction, overhead reduction and all that. But what we're now trying to do is slightly larger, and this has been kind of disseminated to the operating teams itself.

So, there is a separate team that's looking at manufacturing planning and manufacturing costs. For instance, there's a separate team on Value engineering and product cost. The third one that is there is on sales realization itself. We are doing a detailed heat mapping of what's happening in the market, what are the realizations across the various markets, how can you keep tweaking the mix and the distribution to look at improving the net-price realization.

I talked about realization. I've talked about distribution costs. I talked about margins. There are teams on overheads. But what we are trying to do is to use digital in a more wholesome way to drive productivity and reduce cost, which does not add value either to the customer or to the vendor or to any of the people in the chain. So, there's a lot of substitution of effort that is happening.

Finally, we are also looking at productivity of people, and there's a lot of engagement that is happening at the ground level. There's a huge effort in ensuring that the whole team is working towards one goal, and not giving any forward-looking statements, but our plan is to do three or four things.

One, to get deeper penetration and grow the share of business in India. The second one is to ensure that the growth businesses, which is LCV, international, defense, power solutions, aftermarket, grow even at a faster rate so that this helps to devolatize the company, and secondly, also improve the margins.

As I told you, the growth businesses have significantly better margins than the main MHCV business. And exports is going to be something that we are looking forward to because currently, the international markets are very, very choppy, and they have not given us the opportunity for growth as we would like, even though we have been growing in the Middle Eastern markets.

So, this is going to be, for us, very important, and we would want to ensure that we are also introducing very relevant and differentiated products as we move forward. These may not be very large offerings. But one thing that has happened to us has been that the AVTR range and the Bada Dost have done exceptionally well because these have been completely differentiated products that Ashok Leyland is offered, and that has helped us. So, we will continue to look at the benefits of better deeper penetration, cost management, and more importantly operating leverage driving the profitability of the company as we move forward.

Moderator: We have the next question from the line of Pramod Kumar from UBS.

Pramod Kumar: Congratulations on an excellent set of operational numbers. Dheeraj, my first question is on the demand side. You did mention about segments like cements, steel and infra, which are doing well. If you can just help us understand better, given that data availability has got really good nowadays. If you can just help us understand what is the split of demand for the first 9 months for you in terms of broader end-user applications where these trucks are going and categories which are kind of performing better or categories which can still come back in a good like tipper and other categories, which we haven't spoken about? If you can just give us some more color about the demand viz., end-user demand? And what are the sectors which you are kind of optimistic and what sectors can do better?

Gopal Mahadevan: See as I said earlier, it's quite a bit of detail. But broadly, let me tell you what's happening and that is one of the reasons why the industry profitability is also moving better is because we're seeing that there is the demand which has increased quite significantly in comparison to the other sectors in multi-axle vehicles, in tractor trailers and in tippers. These are the more profitable segments.

The second one that is happening is the demand is also going for the larger tonnage. So that is why we are seeing that the vehicles that are getting sold are the 40 tons and 49 tons. So that drives. That's why I mentioned earlier that this helps in the profitability of the industry getting better. ICVs are important for us as a company as well and as a segment as well. We have been gaining growth and share in the ICV segment.

But obviously, the ICV segment is lesser contributing than the heavy commercial vehicles. Now the other point is with respect to sectors, I think almost all significant transport, inducing sectors are doing well. Real estate, again, continues even in the new budget, I think, with the impetus is that has been given you're going to see real estate grow.

Real estate is very important where the transportation is very crucial. Infra, the government continues to kind of pursue on infrastructure, an investment asset growth trajectory for the economy itself. And we are also seeing that almost all industries are posting good growth.

So, if you look at the core sectors, if you look at cement, steel, chemicals, paper all these sectors are doing very well. The other bit that is doing well where we are seeing some bit of ICV growth is, of course is e-commerce.

I think there has been a lot of change in demand pattern, especially after COVID. You see that e-commerce has now become very crucial for the average consumer, and even what is happening is it is not only this. There is also optimization of logistics that is being looked at.

So today, the focus has become that we need trucks, which will perform, which will deliver on time, which will reduce the total cost of ownership. So why I'm mentioning this is we could possibly see a trend where the replacement cycle of some of the BS II, BS III trucks which are there or even to a certain extent, BS IV would start happening faster because today, it is not about just having wheels on the road. It's about getting things on time, point to point. And all organizations are becoming very efficient in their inventory-management.

So, we see a whole host of opportunities coming in. But at the end of all of this, what is most important is the economy must grow. That is where I think India scores and possibly, we will see industry growing over the next maybe 2 years at least going by the global forecast.

Pramod Kumar: Fair enough.

Dheeraj Hinduja: And just one point to add to that. Equally, on the passenger side, as you will see, there is growth coming in, in all areas, right, from staff transportation to schools. Also, huge growth in the electric buses as well, as you heard from Switch. So, across the board, all the segments are showing a very strong recovery.

Gopal Mahadevan: Chairman, I had missed on the passenger side completely. I think that's going to show as you mentioned, a faster growth because we are quite far from the peak volumes that we have had. That's a very good point.

Pramod Kumar: Yes. And just a follow-up on that. On the utilization side, Gopal, because there are factors which are headwinds for the sector like rising interest rates, moderating growth rate, but despite that the industry has really surprised everyone on the monthly velocity in terms of the volumes workouts or what are getting added.

And one cannot forget the fact that the tonnage addition is significantly higher than the previous cycle because the average size of trucks has gone larger. So given all that, what is the feedback you're getting from the end users like if you have to get confidence on next year being a good growth year, utilization of the fleet will also be very important and hence, the replacement cycle or whatever contractual or regulatory new purchase of new trucks. How are you looking at utilization level, let's say, of different categories? And haulage is something which I think you did not mention in a positive light. So, is that category still not doing that great?

Gopal Mahadevan: No. I mentioned haulage also. I said that what is happening, I did mention haulage also that, that's also another sector that we added, all the large trucks are doing well, and so is the ICV. But the pull from the larger trucks, especially in tippers, haulage and I had mentioned tractor trailer ie., all the three. That has also improved the profitability.

See, as far as next year is concerned, as we had mentioned, at the moment, all of us are confident that next year is also going to be a growth year. And given the forecast of the GDP, which we have recently got not only for the current year, for the next year as well, we don't see any logical reason why the demand for trucks should come up because there is nothing unusual that has happened.

In the past, you must remember that we have had a lot of shocks, or I would say, certain developments like an axle load norm coming in or suddenly GST getting introduced or other factors, NBFC crisis coming in, which had actually resulted temporary contraction, but axle load had a much larger impact.

Today, what we are seeing is as Chairman had mentioned, one is we have not yet fully seen the demand of buses coming back because the impact of COVID is just waning, and we are actually seeing people having pulled back up into offices, schools. Intercity transport is going to become crucial, and also STUs would want to place orders.

And now again, as Chairman had mentioned, we are not only going to see demand possibly in internal combustion, but also in EV. That is why for us, Switch is very, very important. Switch is not a portfolio. It is for ensuring that Ashok Leyland is future ready.

The third bit is if the economy is going to grow and they're going to see growth happening in all the major sectors, including the sectors that impacted, there is no reason for us not to plan for growth because it's not just about hoping for growth, this is a very complex industry. We need to plan for it also.

Moderator: We have the next question from the line of Raghunandhan from Emkay Global.

Raghunandhan: Congratulations team on very strong numbers and welcoming Shenu sir on the platform. My first question, Ashok has been doing very well on market share, favorable mix, network expansion. New products have been supporting factors. Can you share your thoughts on how you see the sustenance of market share ahead?

Gopal Mahadevan: Dheeraj, do you want to take it?

Dheeraj Hinduja: Yes, sure. In the last few quarters, we have gradually been increasing our market share and had seen an all-round effort right from the product itself, which are performing very well, as Gopal was just explaining.

And at the same time, the network expansion, geographically, you will see the growth is happening across the board, across the country. And we've been able to increase our market share in every zone that we're operating in and every segment as well.

Going forward, I would say that our aspiration is very much to continue this growth. And as I think something I said earlier as well, but to continue this growth on a profitable basis, we are not looking to buy market share. We want to do this through our better product performance on our customer care and service. We are looking forward to continuing our growth and market share.

Raghunandhan: Got it. Good luck with that. And specifically coming to Q3 revenue performance, can you also indicate how was the performance in the non-vehicle side of business? In press release, you have alluded to aftermarket and Power Solutions business doing well.

Gopal Mahadevan: Yes, I think the aftermarket has done well. I mean, while we don't give specific breakdowns on this, it has been growing at about 25% to 28% as well. And Power Solutions in absolute volume terms for Q3 has been flattish. But on a YTD basis, if my memory serves me right, they have posted nearly about 17% growth.

So, these are very important business for us. Like we said, Defense business has seen some challenge now because of the ordering. It's got nothing to do with the business, but I think what we're waiting for the government orders to happen, especially on the kit side.

So, we'll have more to share with you at the later about, I mean, later part of this year. But otherwise -- and exports is also in YTD terms has grown. Last year itself, it has grown by about 38% to 11,000 units from the previous 8,000. We are certainly expecting the growth in the current year as well.

But we're waiting for the international markets to open up because there is a lot of uncertainty in the international waters currently. But having said that, the international team has also kind of chalked out its plan clearly. There are teams now specifically looking at project orders, and there are teams which are looking at retail distribution.

So, in countries like Africa, while it's a little too early to share those developments, what we have been looking at is how do we get the network in place, how do we get the financing in place, which is going to be important not only for the dealer, but for the end customer as well.

But you possibly would see that the export volumes if things start to return to normalcy in the international markets, you would possibly see that our export volumes will start to gain momentum.

Raghunandhan: Just lastly, can you indicate what is the kind of investments you expect for '23 and '24?

Gopal Mahadevan: We are having our budget season now. So, it's a little too early to share what next year's capex will be. All that I can give you as an indicator is on the regular capex, we do not see any major chunk of investments.

Every year, we give a forecast that we would do about Rs 750 crores, including capex plus investments. So, we'll come back to you for the fourth quarter earnings call. That will be more appropriate.

Moderator: We have the next question from the line of Gunjan Prithyani from Bank of America.

Gunjan Prithyani: Most of my questions have been answered. I have very few, very quick follow-ups. On the margin side, would it be possible to give us some sense as to the 170, 180 basis point gross margin improvement that we've seen. Is it fair to assume that this is coming because of commodity easing? And do we expect that a similar sort of improvement kicking in quarter 4 as well or bulk of the commodity correction is reflected in this Q3?

Gopal Mahadevan: We do have the numbers per se because we do slice and dice it internally. You have seen price increases happening in June quarter, September quarter. We did a price increase, I think, again, in the third quarter.

So obviously, we have got about 4% - 4.5% of price increase happening, right? Now that's a net-price increase. I'm giving some broad numbers. These are not absolute on the dot. The second bit is, of course, steel prices have come off. So that has also kind of helped in the overall margin improvement. So, these are the 2 large things that have actually helped in the margin improvement.

And finally, of course, we have also seen, since you're talking about contribution of our material costs, so I will not talk about operating leverage. But the third bit that has happened has been the mix of the products, which I have mentioned. The industry is moving towards slightly larger tonnage, which is good for the industry.

Gunjan Prithyani: Okay. And this commodity tailwind will still sustain going into quarter 4 is what I'm just trying to understand?

Gopal Mahadevan: We are hoping that that will happen because it's good for the industry. We've had, I think, 2020- 21 and 2021-22 partially were very tough years for the industry, not only because of COVID but also the soaring steel prices that were there, and it's good to see that prices have softened. So, it's very difficult. It's a conjecture at this moment in time, whether the reduction has happened in Q3. Will we see the same amount of reduction happening in Q4 further? We don't know. But like I mentioned earlier, we are expecting that the prices will continue at least at the exit rate of Q3, which is lower than the entry rate of Q3. So, to that extent, there is some benefit.

Gunjan Prithyani: Okay. Got it. The other one was, and I may be wrong on this Leyland Finance. I mean I do see some preference allotment there. I mean, is that something which AL has also participated? Some color on incremental investments have gone into the Finance business.

Gopal Mahadevan: No. Actually, just to kind of give a brief update on Leyland Finance. They had a qualified institutional placement (QIP) happening for about Rs 910 crores, which was announced. So, they are adequate on capital. And that is, in a way, for people who are looking at the Ashok Leyland balance sheet will be positive because there is no demand that will come in from Hinduja Leyland for funding their growth plans. They are adequately funded.

I also wanted to share that they have also announced that there will be a merger with NXT Digital, which is a court -approved process and that is also underway. So with the regulatory approvals and all the necessary shareholder approvals, they'll come through, then the outcome would be that Hinduja Leyland Finance will become a listed company.

Gunjan Prithyani: Got it. And lastly, on scrappage, if you can share thoughts, anything that we should read into the budget incremental impetus or any progress on that scheme, do we see that as an industry growth catalyst for the next 1 or 2 years?

Gopal Mahadevan: Okay. We are also waiting for the detail of the budget notification to come in. But what the government has said is that all vehicles, above 15 years would be scrapped and there's a lot of focus mentioned. It includes passenger cars, etc.,

But we believe that this is definitely a positive, like we have been mentioning earlier, any sort of a policy announcement like scrappage, the government is signaling towards exiting the older vehicles, right? And we believe that this acceleration will happen even faster because of the changes in technology.

We can't have a situation that's BS II, BS III, BS IV, BS VI all plying together when the government is also committed on the environment side. So, like our Chairman mentioned, we see two opportunities.

One, we could see that because of this scrappage, there will be some addition to the replacement cycle. The second one is, because of the thrust on the government, including PLI, we are going to see maybe faster adoption of EVs, which is again good for Ashok Leyland and Chairman, you want to add something?

Dheeraj Hinduja: No, I think, Gopal, you've covered it. We need to see the finer details. And I think since a while the government has been talking about this scrappage policy. And if there is some form of support that comes in from the center to the state government, I think that will expedite it. But if firmer or more clear directions come on this, it will definitely have a good impact for our industry.

Moderator: We have the next question from the line of Hitesh from CLSA.

Hitesh Goel: Most of my questions are answered. Just wanted to touch base more on the scrappage policy. Do you guys are also setting up scrappage centers or you're looking at doing that in anticipation of this policy? Because I think like you said, there's a lot of focus from the government on this. And maybe post elections, we could see something on this front. So have the government started talking to industry on scrappage center?

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

Dheeraj Hinduja: Sure. We have, of course, been considering this since a while. We've explored the contours of what this would involve, but we have not gone into any capex mode at this point of time, just waiting for the final details to be announced.

And then once you learn exactly what this would entail, we would be able to fine-tune our investments accordingly.

Hitesh Goel: So, I just wanted to ask a second question. Gopal, you said that the freight rates have kind of softened, I think Mr. Hinduja said that after the festive season. So why has that happened? Because when I see that there is some slowdown in consumption for sure.

But when I see the e-way bill data, that is growing pretty rapidly. So, truck utilization should not have come off. So, can you shed some more light on this? Is it more seasonal or you're seeing softness in freight rates going ahead as well?

Gopal Mahadevan: I think what we mentioned was more an overall overarching kind of view of what is happening in the industry. That is certainly not a trend.

And I think we don't see any major impacts on freight rates. And we have no data to state that even freight rates will soften further. Chairman, would you want to add something?

Dheeraj Hinduja: No, I think you're right. I mean what I said is the viability of fleet operators remain healthy, although there has been some moderation in the freight rates during this festive season. But I think going forward, the way the market is moving, I do not see softening on the freight rates to happen.

Moderator: We have the next question from the line Chirag Shah from Nuvama.

Chirag Shah: Two questions. First question is on market share. If you can elaborate this a bit. Is it coming from because bounce back in the traditional strong markets or the gain largely coming from non-South markets where we have been making more inroads?

Gopal Mahadevan: Well, Chirag -- Go ahead, yes. Please go ahead.

Dheeraj Hinduja: I was just going to say that, as I mentioned, our market share growth has come across the country. In fact, we've had a stronger growth in the North and East in terms of the overall percentage. I mean, it has been due to the increase in the expansion of our network.

But also, as Gopal has been explaining as well, there's been a strong product pool, which has also helped us. So, there's not only a Southern market growth, but it is an all-India growth that we've seen, the Western markets, Northeast, Central, across the board.

Chirag Shah: This is helpful. Sir, second question was on the nature of demand again. I'm getting some conflicting reports that indicate that small truck operators are still not coming to buy, we are still trying to use the replaced vehicle and older vehicle and the demand is coming largely from medium and large fleet operators. Is this information correct? Or you are already seeing some interest coming from small truck operators also?

Dheeraj Hinduja: I think if I'm not wrong, demand from larger truck operators comprise anywhere between 60% to 70% of the overall industry volume. And what we're also seeing is that the smaller operators in some way are getting tied up with the fleets as well. And we are seeing a lot of purchases from the first-time users as well.

Of course, from a content perspective, led by in 50s or hundreds of units. But I would say that we actually see the demand coming from all segments. It's not only restricted to the fleet operator.

Chirag Shah: Yes. And just a clarification, you indicated that at least for Q4, the commodity benefit is going to be similar or maybe a little bit soft, right? So, is it a large part of the benefit has come through and then how one would play out will depend upon how the prices behave from here on? Is it the right way to understand on the commodity assets?

Gopal Mahadevan: You are asking a tough question and asking us to peer into the crystal ball. We'll have to really wait and watch how the commodity plays out, right?

When the export duty was more on steel, there was a perception that steel prices will harden. But they haven't because the point is that the Indian prices still continue to be higher than the global prices. So, at the moment, all we can see is visibility to fourth quarter. And even the fourth quarter, the commodity prices continue to be at the third quarter level or at the exit level as we kind of believe it will be, then it would have a positive impact.

Of course, if it falls even further, then it has a greater impact. But these are all imponderables at this moment. But we haven't seen -- all we can say at the moment is sitting on the 2nd of February, we haven't seen a further decrease happening in commodity, but neither has there been any increase.

So, at the moment, it looks like it is at the third quarter levels. The 1st of April, I mean, in Q1 of next year, we'll have to really wait and watch to see what happens in the global commodity markets. Because it's not just about Indian commodity, right? It is a lot of things is going to depend on the global demand-supply condition also. So, we'll cross the bridge when it comes then.

Chirag Shah: And we are a kind of a quarter lag, right, for the impact to flow through for us?

Gopal Mahadevan: Yes, in a way, yes, because of 2 reasons. That is inventory as well, right? I mean so you are seeing that benefit. So, there is FG inventory, that is RM and WIP, which is there, then so when that needs to get used in.

And then typically, the industry also doesn't settle on a month-on-month. You know the steel industry; these are done on a quarterly basis. So, we have to actively engage with them to settle these prices.

Moderator: We have the next question from the line of Arvind Sharma from Citi.

Arvind Sharma: Just 1 question on the net debt. If you could just explain how it has progressed from last year end, essentially the free cash flow generation, capex and how the net debt has progressed over the last 3 quarters?

Gopal Mahadevan: Yes. Our net debt now is about Rs 2,043 crores, and in Q3 of FY '22 it was Rs 2,697. I think the number was almost the same, Rs 2,677 in Q2 of FY '23 also. The capex is roughly about Rs 346 crores.

So, we are well on track and are conservative on the capex. We're tight on the capex, and there are multiple levels of discussions before we spend money on that.

And overall, if you look at it, the net-debt levels have been improving, and we don't see an issue on that. I mean I don't know whether you have a specific question on that.

Arvind Sharma: No, sir. And would you have any -- since you have some idea about the capex in the fourth quarter, any idea about where we could end up fiscal '23 at? Because I mean the EBITDA margin is expected to be better given the volumes. So, do you think that this could improve significantly over the next quarter?

Gopal Mahadevan: So, you see, as I mentioned, I stand corrected on this, it's not Rs 343 crores but Rs 321 crores So, the capex was Rs 321 crores. We had at the beginning of the year, said that it will be around Rs 750 crores, maybe we'll end up with Rs 600 crores.

All I can tell you at this moment is we have 2 months more left. It should be lower than Rs 600 crores definitely. Maybe we will even take it a little lower than that, but we'll share that. So all I can tell you is it's not a material amount of capex that we have today in the current half.

Moderator: We have the next question from the line of Jinesh Gandhi from Motilal Oswal.

Jinesh K. Gandhi: My question pertains to the capex itself. I mean, given that we are expecting a strong growth to continue in FY '24 and given our other investment programs, should we look at increase in pace of investment going forward for the future growth, both on product and capacity side?

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

Dheeraj Hinduja: I would. Yes, sure. I think on the capacity side, we are, as Gopal was saying, we are looking at all the internal efficiencies that we can bring in debottlenecking within the plants wherever there are possibilities.

So based on the current volume that we are foreseeing, I think we should be able to manage with the capacity that's on ground. We do not want to get into creating more overhead at this point of time. With regard to the product, as you recall, the introduction of AVTR as a modular platform, the benefit of it is that with very minor modifications, we are able to meet whatever the customer requirements are and in alternative fuels as well.

So moving to whether it's CNG, hydrogen, LNG and I think that's the benefit of the AVTR platform. That was the high Capex that we went through. There are certain product categories that we are not currently present in, and we would be looking into setting up any gap that we have in the portfolio. But at this point of time, I think we are not seeing anything substantial to hit our Capex requirement.

Chirag Shah: Okay. And just to clarify, the investment on the electric vehicle products, particularly on the LCV side, will be done through Ashok Leyland and not through Switch, is that correct?

Dheeraj Hinduja: No, like all the products coming out of Switch, the capex will be borne by Switch directly. And so, of course, there is an agreement between Ashok Leyland and Switch based on which these products would be utilized, but all the capex required for the electrification would be borne by Switch directly.

Jinesh Gandhi: So, in the Bada Dost EV product investment could be at Switch level, not at Leyland level.

Dheeraj Hinduja: That's right.

Moderator: We have the next question from the line of Mukesh Saraf from Avendus Spark.

Mukesh Saraf: Just one question from my side on the fleet operators. So, what we are hearing from large ones such as VRL is that the smaller and more unorganized fleet operators are losing out. So, the question here is what does this mean for us? And do we see the product mix probably shift towards larger trucks or mainly fully loaded trucks?

And on the other side, does it also mean that the pricing gets a lot more competitive given that the large operators might bargain harder? So how does this clear out for us?

Gopal Mahadevan: I think from a product segment perspective, irrespective of the buyers, whether it's first-time users or whether it's fleet operator, what we see is that there is a clear segmentation on the delivery models that people require. So right from an LCV, ICV is still remaining the larger segment of the market.

So, looking at the fleet tonnage between 9 to 18 tons, still is a very large segment. So, while we're looking at the whole distribution cycle, the last-mile delivery to the long distance that's needed across the country, I think we will continuously see all the different product categories are growing based on the market demand. what was the second part of your question?

Mukesh Saraf: So, it is basically when you deal with, say, larger operators, would it also mean that you don't get that much of a pricing power with them?

Gopal Mahadevan: Well, I think a lot of it also depends on the demand itself and today, the demand remains very strong. And the competitiveness of other OEMs as well, how they are pricing. But as you are seeing currently the prices are improving based on the current demand requirements.

So I'm not seeing any decline or reduction in terms of our ability to price our products.

Moderator: That was the last question. I would now like to hand it over to the management for closing comments.

Dheeraj Hinduja: Thank you and thank you for your interest in Ashok Leyland. And I think as we mentioned, we've had a good quarter. We're seeing this trend to continue. The government commitment towards their capex and possibly the scrappage scheme introduction as well, all holds good promise for our sector. And we have grown our market share in the last few quarters, and we continue to do so. And this is across the country market share growth, and across the various product segments as well, including the passenger vehicle side.

So, all in all, we remain very upbeat in terms of the prospect for this industry and for Ashok Leyland as a whole. Gopal, would you like to add anything further?

Gopal Mahadevan: No, I think you have wrapped it up, Chairman. So, we hope that we are able to continue with the performance and the macroeconomic factors continue to support the growth of the industry, and we'll have more to share in the fourth quarter. Thank you very much.

Dheeraj Hinduja: Thank you.