"Eicher Motors Limited Q1 FY20 Earnings Conference Call"

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Moderator: Good day ladies and gentlemen and a very warm welcome to Eicher Motors' 1Q FY2020 Earnings Conference Call hosted by HSBC Securities. As a reminder, all participant lines will be in the listen-only mode and there will be an opportunity for you to ask questions after the presentation concludes. Should you need assistance during the conference call, please signal an operator by pressing "*" then "0" on your touchtone phone. Please note that this conference is being recorded. I now hand the conference over to Mr. Yogesh Aggarwal from HSBC Securities. Thank you, and over to you, Sir!

Yogesh Aggarwal: Thank you Ali. Good evening everyone. On behalf of HSBC, I welcome you all for the post results conference call of Eicher Motors. We are joined today by Mr. Siddhartha Lal – MD, Eicher Motors, Mr. Vinod Dasari - CEO, Royal Enfield, Mr. Lalit Malik - Chief Financial Officer and Chief Commercial Officer, Eicher Motors. I will now hand over the call to Siddhartha for his opening remarks that will be followed by the Q&A session. Over to you Siddharth!

Siddhartha Lal: Good evening everyone and thank you for joining us for the Q1 results of Eicher Motors Limited. I am Siddhartha. I am going to tell you first about our consolidated financials for the quarter ended June 2019. So as you have seen in the financials, our revenue was at Rs. 2,382 Crores, which is down 7% from the same quarter last year and resulting in an EBITDA of Rs. 614 Crores, which is down 24% and an EBITDA margin at 25.8% against 31.8% last year. All of that resulting in a PAT of Rs. 452 Crores, down 22%. Particularly on Royal Enfield business update, our motorcycles sales is down by 19% to around 1.82 lakh or 182,000 motorcycles for the quarter, so that largely of course India, which is negative, but the exports has done well even though it is on a small base of 5,600 motorcycles last quarter. It has gone up to 9,600 motorcycles basically on account of very strong response to twins around the world, so that is for the exports.

Our network, we continue to expand. We added 13 stores in India going up to 928 and we continue to add stores. We added six stores in international market exclusive stores that is and taking the total count of exclusive stores up to 48 and obviously many hundreds of multi brand stores as well. We have entered South Korea with the first exclusive store in Seoul. We have added two stores in Brazil and one each in Indonesia, Vietnam and Argentina, so we are continuing with that plan.

We had announced earlier this year our plan to add new studio stores in smaller towns in India, so the initial plan at the start of the year was to add 350 studio stores, which are a smaller format store in this year. We are happy to say and Vinod Dasari has been championing this of course that we have really increased that number tremendously so we will be on track to opening these 350 stores within the first half itself and we will add further studio stores so that is really helping us in our reach in smaller markets across the country.

The twins as I said have got enormous interest across India and the international markets and we are doing exceptionally well. We have won all the big awards we could have won and we have got on all the big covers of magazines. We won a lot of comparison test against Japanese, European and American brands, so it is really world class product that people are seeing enormous value and that it is as refined as anything else in the market, so it has been enormous halo product for Royal Enfield across the world and giving us a lot of pull in markets from customers, from dealers, from media everywhere, so it is really helping us in unprecedented ways. For example, we have become the number one selling Naked Street motorcycle in the UK and that is just having entered the market. It has already reached there and similar stories across the world where the Interceptor and the Continental GT are really taking market by storm and therefore we are continuing to ramp up our production for our twins as we speak.

We are also very much on track with our transition to BSVI well in time for the regulatory requirements. All our platforms and all our new products all of them are planned in a manner where we will have a phased transition and clearly we are planning to have zero stock on March 31 that is how we are working out the transition plan of zero stocks of BSIV product so that BSVI is available in the last quarter of this year and of course then 100% from April onwards of 2020.

As far as our plants are concerned, our Vallam Vadagal phase two, the building is over. The equipment installation is underway and the facility will be available for production as per the original plan. Our Chennai Technology Centre, the product development part is completed and we have moved in there. We are already doing testing, validation of our BSVI products in that new facility in Chennai, but this site will also be the new headquarter for Royal Enfield, so that the administration blocks and all are nearly complete and we will be moving in the next couple of months, which becomes really the base for Royal Enfield in the future. Lot of people are going to be moving in there to the New Technology Centre our headquarters in the coming time.

The rides and events continue very strongly. We had the 16th edition of Himalayan Odyssey with 60 riders covering 2,200 kilometers and it included participants from around the world and more than just a simple ride now, we are putting a lot of emphasis on sustainability on various other aspects of our rides, so this time we made this as a zero single use plastics ride so not only did we not use any single use plastic during the ride like water bottles and other such things, we also added to the communities by installing water purifiers along the way of our rides in six different locations and other such things, so leaving every place better where Royal Enfield tread, that is our attempt of course.

Moving on to our joint venture with Volvo, VE Commercial Vehicles Limited, from a revenue perspective in Q1, the revenue was Rs. 2,255 Crores, which is down 14% from the same quarter last year. EBITDA is at Rs. 125 Crores, which is down 48% resulting in an EBITDA margin of 5.6% against 9.2% last year. Profit after tax was at Rs. 38 Crores down 68% and total sales for Q1 were at around 13,300 units down 18%. The commercial vehicle industry has been extremely weak last quarter. Sentiments are low. The liquidity is not there in the market and dealers are also under stress, so there are a lot of such things and general economic slowdown has resulted in a lower replacement demand for trucks, so all of that is affecting the industry. Further the discounting is at all time high levels and that is affecting our EBITDA margins as well.

Having said that we have also had some positive news and progress. Our Pro 2000 series, which is the new light duty platform from nearly five tonne to 12 tonne has been unveiled and it is the first BSVI compliant range, but of course it has been launched first in BSIV as we speak, but eventually will be available in BSVI in time for that. It is a very strong new product range in light duties and we expect to gain market share in light duties with this new product range. It is absolutely class leading as a modern product introducing many industry first features like all wheel disc brakes, touch-screen infotainment, steering mounted controls and advanced telematics, which really helps productivity improvement, so all of that has come in our new Pro 2000 series, which we are delighted about and it has been powered by two new engines platforms and the payload capacity actually in this range is from 2.7 tonnes to 7.2 tonnes so that is on the Pro 2000.

We are also preparing and on track for BSVI in the VECV. As you know we have manufactured and delivered tens of thousands may be 100,000 plus Euro VI engines, which is equivalent for the medium duty engine platforms to Volvo globally. So VECV really has an enormous head start over competition as far as BSVI is concerned because we have gone through the learning curves in production area and in the design area. We have produced a lot of these engines already for markets around the world and similar treatment will be done to the engines available for India, so the learning curve is very strong. We have a very strong understanding of BSVI already and I believe that give us an edge as the industry moves to BSVI and a higher level of modernization. We see we will certainly have an edge and Eicher brand of trucks and buses should be able to benefit from that.

There could be a bit of pickup in the CV industry post September with the onset of the festive season and of course in the last quarter of this year January, February and March of 2020 there is possibly going to be quite a bit of pre-buying before BSVI comes in and the prices go up for trucks and buses. So that has been our quarter for Eicher Motors Limited and now I am open for some questions.

Moderator: Thank you very much. Ladies and gentlemen, we will now begin the question and answer session. The first question is from the line of Kapil Singh from Nomura Securities. Please go ahead.

Kapil Singh: Thanks for the opportunity. Firstly, I wanted to check on your volume outlook if you would like to share any number or any qualitative input there also because we are starting Vallam phase 2 so is there a threshold level of volume at which you will start it or any ways it will go ahead that is the first question?

Siddhartha Lal: Well at the beginning of the year the plan was that we will work towards a 950,000 production capacity so that basically means the manning for production, etc. So we are in line with that. Of course if things change and the plans change over or let us say the market continues to be as sluggish as it is now and it does not pick up then we may have to do something later, but as of now that continues to be the plan for 2019-20.

Lalit Malik: Kapil, Vallam phase 2 kind of also comes in at even if the volume remains sluggish through the year and all for which we do not know yet, but there are already the parts of the plant or the new phase that we will for sure use like paint shop. I am sure we will have some use for it because we are always short of painting capacities. There will be some machining that we have put up in phase 2 of Vallam Vadagal that we might use. There will be bits and parts, which will 100% add to the overall robustness of the supply chain.

Kapil Singh: That is helpful. When are you starting it?

Lalit Malik: In the next month or month and a half.

Kapil Singh: Secondly just on the staff cost I see there is a 23% increase for the quarter so is that a run rate we should assume for the full year or will this increase further with Vallam phase 2?

Lalit Malik: Sorry, which cost are you talking about.

Kapil Singh: Staff?

Lalit Malik: Staff cost, so this is the end of the hiring program that we had for last year and of course the increments and all that stuff, which was always a Q1 phenomenon. I do not want to stick my neck out too much about this, but I think here on you will see a lower run rate for sure.

Kapil Singh: Despite starting Vallam phase 2 it should be lower?

Lalit Malik: The incremental cost of starting Vallam phase 2 will not be that high because we are not adding like full management teams over there. It is an extended part of Vallam phase 1, so there will be a lot of leverage from a cost perceptive and it is a more automated plant than the plants you have seen in Oragadam.

Kapil Singh: Got it and lastly I just wanted to check would you comment on the footfalls and the conversion rates across the network how it has moved in 1Q?

Lalit Malik: Q1 was largely an extension of Q4 so there was sluggishness in the walk-ins and all that stuff, but I have to say some of the online search and some of the field inquiries kind of increased a bit, but the overall walk-in phenomenon continues to be weak at this point of time. May be later when Vinod will talk about it, there was a lot of stuff that you will see from us happening in the next two months on quite a few fronts that will hopefully trigger higher walk-ins including of course the studio stores, so I will just hand over to Vinod to have a brief on the studio store plan that were changed a bit.

Vinod K Dasari: At the beginning of the year, we had a plan to set out 350 studio stores by the end of the year, but realizing that we need to enhance the walk-in and the only way to do that our customers were saying is to give us greater accessibility in the up country areas both for sales as well as for service, so we accelerated the plan and I think not only we will exceed this plan of 350, we will probably do 500 and the better part is that we will probably finish it in this quarter itself, so we will have 500 roughly 450 to 500 operational by the end of this quarter, which would be a big jump in our network. That would give the walk-ins that you are talking about.

Kapil Singh: Thank you Sir.

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

Pramod Kumar: Thanks a lot for the opportunity and one accounting question on depreciation side as well as there has been a sharp jump there just wanted to understand how much of this is probably pertaining to some bit of a write off of the BSIV technology or components or is there anything pertaining to the new platform of the BSVI technology, which has started getting amortized at the start the fiscal?

Lalit Malik: No nothing on BSIV or anything like that. It is just a new accounting standard, which is applicable from April 1 called AS 116. It has got to do with the lease, rentals and all the stuff, so it is an adjustment towards that.

Pramod Kumar: That will mean that expense line would have moved from other expenditure line to depreciation what is the nature of movement there Lalit as in that kind of overstate EBITDA?

Lalit Malik: About Rs 7 Crs.

Pramod Kumar: Rs 7 Crs for the quarter and that is a sustainable run rate and the rest is related to your expansion or towards Vallam or the equipments, which have come in and all that is that right or will it step up further as Vallam comes?

Lalit Malik: No Vallam depreciation quite a bit margins over there because as you know once we start the pilot in any mid fashion we have to start the depreciation.

Pramod Kumar: So Vallam is already in the numbers?

Lalit Malik: Yes.

Pramod Kumar: That is good to hear and on the question on demand side Siddhartha as of course this is an industry wide sluggishness we have not seen any meaningful change in your segment share in 200 CC plus category as such so just wanted to understand what is your check from the sales and the marketing side with customers and dealers what is the common excuse or what is the reason why all of a sudden things have slowed down so much and what will be the two to three asks, which you think the customers are looking for, which can probably turn this around from a demand perspective?

Vinod K Dasari: The first thing that the customers are asking for is greater accessibility, which as I mentioned we are not only providing, but significantly accelerating our own plans and they are asking for greater number of variants so that they have more different type of products to show through and that is something that we are working on also. Equally we are pushing our non motorcycle revenue up. Our spare parts sales are higher than last year although that is minor and another minor thing, but very important is our growth in international, which Siddhartha pointed out is up 72% over the last year. Despite the sluggishness I must say that we are doing very well even in India not just on the Twins, but what often does not get talked about is the substantial success that we are having with the Himalayan, so our core Classic is down, but Bullet is up, Himalayan is up, Twins are up, so I think with some excitement on the Classic also that we are thinking about that would probably bring back the market.

Pramod Kumar: Is the understanding that 650 response remains strong because whatever we checked the waiting periods are still pretty robust and you still have not gone deeper in terms of the network of the 650 and if you can just talk there about what is the kind of numbers you are planning now because initially I thought the plan was up to 5K and now I think you have already crossed 4,000, I still see a reasonable amount of demand with the 200 odd stores where you are selling, so if you can just help us understand where do you see the 650 ramp up and connecting to that is the new platform roll out and if you can put some timeline around that I know it is a bit confidential, but will it be kind of with BSVI and what would be the kind of broad expectations because it is like almost after more than a decade that you are going to have a meaningful replacement for the existing portfolio, so if you can talk more about that Vinod or Siddhartha?

Vinod K Dasari: I think you have several questions, I captured the first one, which was on Twins the waiting period is still about 3 to f4 months and despite us ramping up the production close to 5K, I think we will be expecting about 5K this month somewhere around 4700 in August probably may come and as far as variants and all we continuously talk to customers and take their feedback and as and when we get a positive feedback towards a particular type of variant we will continue to work on that. It is not like one major thing that we are planning that we have to hold it at the same breadth, but BSVI we are ready across the platform. We are on the road to be ready and I think very soon we will be ready.

Pramod Kumar: So fair enough. Thanks a lot and best of luck. Thank you.

Moderator: Thank you. The next question is from the line of Venugopal Garre from Bernstein. Please go ahead.

Venugopal Garre: Thanks a lot for the opportunity. I just wanted to understand I was a bit curious to know over the last 12 to 18 months you have actually stepped up our dealer network in terms of the number of the dealers you have added last year as well as the plans that we have. Now incrementally in general there seems to be some concerns on dealer health and I think the last couple of months there has been comments on banks to about wanting to sort of moderate financing to the auto sector dealers. So I just wanted to understand from your own perspective how do you sort of look at or how do you find your dealer health at this juncture and more importantly the new dealers that you have added over the last let us say 12 to 18 months, are they in a shape where you would not have to go and incrementally support them by any measures?

Vinod K Dasari: I think majority of our dealers, I would say most of our dealers are in decent health. They could be much better. I think because of the volume drop, everybody is feeling some of the pain. But what was this recent talk about some 20 - 30 dealers, which got a notice or something like that, I am told. That was all unrelated to Royal Enfield completely. That was because some dealers, they are all small entrepreneurs also. They had probably diverted some funds here or there that the bank did not like. It is not something that we get into involved with the bank. And we make sure that our dealers are not defaulting because of Royal Enfield. We have brought down the inventories over the last few months and now it is less than a month, so nobody is defaulting because of the inventory or anything like that from Royal Enfield. There were, of course, some few bad apples in every set of dealers. So some guys have done some things, which the banks do not like and they have canceled their financing. But that is between the bank and them, it is got nothing to do with Royal Enfield.

Venugopal Garre: Okay. Secondly, I am not sure if you are going to answer this question, but there has been a lot of news articles about potential 250cc product that Royal Enfield is going to work on, it is going to take three years for the product to come out, etc. Should I consider this as speculation? Because I think you've generally been of the view that you do not really want to move below 350cc?

Vinod K Dasari: Well, first of all, we never said anything about 250cc. I do not even know where that is coming from. I think Royal Enfield is, and I am fairly new here, so has always said that Royal Enfield competes in the segment of 250cc to 750cc. So that is why people probably thought that we will bring in a 250cc. I mean, I will answer that question directly. There are no such plans. So there is speculation in the market, and I cannot go after every speculation and answer those.

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

Binay Singh: Thanks for the opportunity. In one of the comments, I think, Vinod mentioned that the customers are looking for more variants. Could you expand on that? You said one of the few things customers wanted more accessibility and more variants. So how are you planning to address more variant part?

Vinod K Dasari: It is a longish answer. I think I would like to spend some more time with you at some point, but one of the things that I love about this new industry that I have come to learn about is where, unlike a B2B sale, this is a B2C sale and the customers are actually buying this. This is an expression of their personality. So what can Royal Enfield do to help them showcase their personality much more so customization, personalization, more variants, more colors. This is how we are building the capability at every level of the company. And that is what I mean by more variants so that the customer has more options, not just on accessories, but on apparel, on colors, on trends and graphics and what not.

Binay Singh: Okay. And you also talked about 500 studio stores by end of this quarter. That seems pretty quick ramp-up in this sort of liquidity-crunch environment. What sort of an impact do you think will it have on mix and volumes? Like, when do we actually like what kind of volumes do you think can it bring in? And how will that impact mix?

Vinod K Dasari: So half of those will be done this month itself. Balance of them, we are working on. Hopefully, before Diwali, we will finish everything. And these are all by, if I am not mistaken, all by existing dealers creating new branches. And they are maybe 600 square feet and 100% as per our brand identity, so but much lower investment by our dealers. And they do sales and service. This is not just sales point. So it enhances the accessibility and the service reach of our company substantially, a 50% increase in 6 months. That is the pace at which we are moving. And each one of them breaks even, I think, if they sell 10 bikes a month.

Lalit Malik: Even less than 10 bikes.

Binay Singh: I think this will be interesting to see because it is a very aspirational brand. So hopefully, the new format also keeps that pace. And lastly, just on financing side, could you say about that?

Vinod K Dasari: I should add that 60% of the market for this aspirational brand is actually outside the main cities. So we have to reach out to those people, otherwise they have to come to the city. So that is why we are pushing this more aggressively.

Binay Singh: Yes, I know that. That is interesting. And what was your finance penetration? Anything or ways you are planning to increase it over a period of time? Because that can really address the affordability issue if you increase finance availability.

Lalit Malik: It is the same like around 50% to 53%, no change on a quarter-on-quarter basis. Plan to increase if we do not plan to increase, but if the customer wants financing, then we should be ready with financiers, choice of financiers, and the choice of products they have. So that is the back-end work that we are doing with all the financiers, which is a regular thing. I mean, nothing more to be done.

Binay Singh: I will come back in the queue. Thanks so much.

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

Mihir Zaveri: Thank you for the opportunity just wanted to ask, so in case of 950,000 when we keep talking about the production capacity. So in the wake of the demand slowdown, how should we look at it? So is not it prudent to just give some of the demand guidance? How do you look at demand from the 1-year perspective given the fact that, basically, the demand has been quite sluggish? And secondly, also that our new production capacity is going to just add up to the 950,000 so just wanted to understand how relevant that is. And secondly, in terms of inventory levels, did I hear correctly the inventories right now at 1 month? Is it 1 month?

Vinod K Dasari: Less than 1 month. Dealer inventory.

Lalit Malik: The channel inventory is less than 1 month. The dealer inventory is far less than that.

Mihir Zaveri: Okay. So in that sense, just in the first question, so how should we look at it? And what is the relevance of this 950,000?

Vinod K Dasari: I think when Siddhartha was talking about 950,000 that was creation of the production capacity of 950,000. And, of course, if the market was there, we have the capacity to get to that level. So our job now is to find ways and means to enhance the market, whether through network, whether through variants and whether through new products. That is what our goal will be. Royal Enfield production was the constraint, and so the point now being that production is no longer the constraint. Hopefully, we will work towards making it a constraint again.

Mihir Zaveri: And in the wake of this demand slowdown, will the new capacity anyway is going to come in and that is only going to add up right to the 950,000. Why I am asking is that the run rate, basically, what we have currently is sub 60,000, which does not add up to even around 8,00,000, kind of a number, for the full year, even if I were to add around 65,000 from hereon. So I just wanted to understand from Siddhartha and Vinod Sir that how should we look at probably from a number point of view for FY20, how should we look at?

Siddhartha Lal: We cannot answer that in terms of what the demand will be because one, we do not give forward guidance on demand. The production number we gave was what we are planning to set ourselves up for the year, because that is what we estimated we will require for the year. But that is only from a production perspective, right? And from a demand perspective, who knows, I mean, we are working towards improving the situation, but we did not expect demand to be down this much. So we are working towards it. It is impossible to say what is going to happen in the future. We can only work towards all the levers that we have under our control and that is what we are doing. We are adding a lot more stores. We are doing a lot more variants. We are doing a lot more work on walk-ins, demand generation, and whatever will result, will result. You will see the results as they come out every month. You will get to see what the sales numbers are. So there is nothing more we can add here in terms of what the demand position will be.

Mihir Zaveri: Fair enough Sir. Thank you that is it from my side.

Moderator: Thank you. The next question is from the line of Jinesh Gandhi from Motilal Oswal. Please go ahead.

Jinesh Gandhi: My question pertains to standalone RM costs. So it seems there is some increase on Q-o-Q basis. Is it anything to do with mix, or have we seen any actual cost inflation?

Lalit Malik: There has been hardly any cost inflation. If you remember, some of the benefits of the costs flattening out, because it is yet to be seen, I am hoping we will get to see them in Q2 and Q3, if the cost lines are as stable as they are at this point in time. This has largely got to do with the fact, if you remember in Q4 also, we said because of the full transition of ABS, there were some elements of the costs, that were passed on of course, but not the full margins. Now because we have not taken any price increase in Q1, the sale that has flown through in Q1 as well so beyond that, yes, there is no other reason beyond that.

Jinesh Gandhi: Okay. And similarly, other expenses also have come down reasonably well on Q-o-Q basis, despite lower I mean, so one is, obviously, variable cost. But is there any one-off item there? Or it is largely a reflection of AS 116 impact?

Lalit Malik: So AS 116 is a part of that, but there are a whole lot of cost initiatives also began last year. We continue to work on them, and certain non-material cost initiatives. So the impact of some of them you are seeing now, some of them you will see in the next few quarters as well. One of this is, yes, for sure, in Q4, we had a bit of Twin launches in India, around the world and all that. So those are of course not there in Q1.

Jinesh Gandhi: Secondly, with respect to our vintage stores now since we have presence in 8 cities, any initial feedback which you are getting from the vintage stores? Are people coming in to trade in? And is that getting some bit of momentum?

Lalit Malik: So great news at the brand level, but fairly bad news at the vintage level. People are not coming for trade in. They still like to preserve the bikes and hold the bikes and all that stuff and the whole idea about vintage was, when the time comes for people to really trade in or replace, whenever they come to do, we should be ready with that. So it is a slightly longer-term kind of a thing. But the 10, 12 or so that we have, I think, almost all of them are doing reasonably well. The problem continues to be sourcing of old Royal Enfield bikes.

Jinesh Gandhi: Okay so that underlying objective is still not being fulfilled with respect to offering trade-off there, trade-in there?

Lalit Malik: At a larger level, we do not have any replacement demand in the company. So there are new customers, and that is one of the peculiar things about Royal Enfield, pretty much all the sales that you see is due to new customers.

Siddhartha Lal: So even with products like Himalayan and especially the Twins, we expect a lot more replacement. So a lot of this work for vintage stores was done in preparation for the Twins, when people come in with their Royal Enfield singles and want to upgrade. That is very much the objective and we were working towards that. In fact, it is merely a positive thing because actually, we have not been working really hard towards sourcing more Royal Enfield bikes. So we are not able to find enough secondhand Royal Enfield bikes in the market. So that is a good thing actually, because that means there is not a flood of motorcycles. That means that the residual value of a Royal Enfield is still very high. And that is actually our biggest objective as well, right, for these vintage stores. So whatever secondhand bikes there are, I mean, we are stocking them up and bringing them in, so we have now a channel to sell secondhand Royal Enfield bikes, but that there are not that many in the market is actually a good sign.

Lalit Malik: You know, as I spoke at the Investor Day as well. It is about half the Twin customers, are old Royal Enfield customers, half of them are outside of Royal Enfield. So like I said, they are not enough people who want to come in to sell.

Jinesh Gandhi: Understood. Lastly, with respect to BS-VI transition, this question has been asked, but considering that we are seeing a reasonably good response for relatively new products like Himalayan, Twins and that way, would it be fair to say that Classic is seeing some bit of fatigue in terms of brand or product and would it make sense to launch BS-VI of Classic and Thunderbird relatively earlier than the deadline and if that is the case, what kind of time line are we looking at?

Lalit Malik: That has nothing to do with Classic. I mean, don't mix up, I would say, larger macro headwinds, weak demand, consumer sentiment and all that with our good old Classic. Every time that we have done something on the Classic, it has done exceedingly well. Like, if you see the last two, three years, starting with, which is about 2, 2.5 years back; Signals, which we did last year. So Classic still continues, I mean, in most parts of the country, apart from strong Bullet and strong Thunderbird territories, it is just Classic. So incrementally, we would never have the confidence to open more stores if we knew that there is a fade on the brand or fade on the Classic brand. I think it is still a very strong and evocative product that we have. Further, we have not evidence as a marketing measure or any other measure like that, that there is any fade on Classic at all.

Jinesh Gandhi: Okay. Because only with, I mean...

Moderator: Mr. Jinesh, I am sorry to interrupt to you, may we request you to come back in queue for follow-up questions. Thank you. The next question is from the line of Gunjan Prithyani from JP Morgan. Please go ahead.

Gunjan Prithyani: Hi thanks for taking my questions. I just have two follow-ups, firstly, on the margin side as we go to the remainder of the year, do we see any meaningful RM or commodity-side tailwinds? And as the Twins ramp up, do you see any improvement in the margins going ahead? Or you think that this 26% EBITDA margin that we have reported is kind of the level we are going to see through the year? And just in this context also, given that you are now talking about the accessibility in newer markets. That will entail some higher promotional spend, or I am not sure what kind of spend we will be doing around that. How does that impact the margin outlook for this year?

Lalit Malik: So question number one, on the overall margins of the company, I mean, rather than us speculating, I promise, every quarter, we will come back to you with report actual margins of the company. So please wait for every quarter end. Point number two, on the studio stores that we spoke about, although we want to open a very large number over the next few months, I do not expect any studio promotional expense and stuff like that. It is pretty much what is already in the normal run rate of the company that you have seen us do A&P spends, it is just going to fall in line over there. And these are all local, very local, so one-off press conference, some spend, that kind of stuff will happen.

Gunjan Prithyani: And any commodity tailwinds? You do not have any I mean, in your guidance, you would want to give around that?

Lalit Malik: We have seen the softening of key commodity prices for the last 4, 5 months now. And we're continuing to be stable. So when the overall world demand is soft, these commodity prices tend to come down, which is what we are also seeing at this point in time.

Gunjan Prithyani: Okay. And the other thing was on I mean, you have spoken about increasing the footprint. But there are some of the larger markets, where clearly, demand has come off very, very meaningfully. Is there anything specific we are doing in terms of creating more excitement in these markets, because the product launches still some time away? Or a refresh around BS-VI of Classic 350 is still some time away, too, so is there anything that we are doing, which you can share with us around reviving the demand in the mature markets?

Vinod K Dasari: We do not want to talk about future product launches and all that. But you will see some more activity on that, very soon.

Siddhartha Lal: Yes. So more variants but also, I think, very importantly, in the mature markets, which you are talking about. The, of course, some of the volume has come off because of various other reasons. But the growth eventually will come from higher level product because that is where we want to see the replacement. So Himalayans and Twins and all, I mean, will provide the growth, whereas Bullet, Classic kind of will provide the base, right. So there will obviously be new people coming into the market, but the actual growth will come from the newer platforms that we have launched, and which are now really getting established as the next level platform. So where we have very large market shares in places like Delhi, Kerala or Bangalore. We expect that any growth there will come with the extended efforts. And we are doing a lot more seeding efforts because for us, it has been around. We have been working on the Twins for a long time, we know Himalayan. But for people in those markets, maybe they are not fully aware, they have not ridden or test ridden a Himalayan yet or a Twin. So work, there is still only at the early stages. And as we get deeper and as we understand how to sell it better, because there is also a lot of concept selling, right? I mean, Himalayan, there is no adventure tourer bike in India. So how do you sell an adventure tourer? We have learned that now. And now we will be able to deploy that much better, and especially in markets where we already have higher market share. So in those markets, in addition to the variants that we talked about - Vinod talked about, we have huge focus on products like Himalayan and the Twins in mature markets.

Gunjan Prithyani: Okay. And just lastly, there have been some talks about road tax increases in some states, specifically, Rajasthan. Is there anything - I mean, are there more states which have taken such kind of increases, if you can talk about it?

Lalit Malik: I mean, obviously, in Rajasthan only, which happened a couple of weeks back. But it is pretty much a state subject. So they can do whatever they want to do on the road tax.

Gunjan Prithyani: But besides Rajasthan, we have not seen any other state? Last year, Karnataka also had an increase, right?

Lalit Malik: Karnataka had an increase in year 2017. Yes, you are right. Rajasthan now, and in between that, we saw a little bit from Kerala as well, on certain higher CC bikes, which again means us only. So yes.

Gunjan Prithyani: Okay, got it. Thank you so much.

Moderator: Thank you. The next question is from the line of Jay Mehta from Edelweiss. Please go ahead.

Chirag Shah: Yes. Chirag here from Edelweiss. I have two questions. One on this raw material price. Can we assume that the product mix side and the cost increase that you have done, there an incremental deterioration in gross margin is unlikely, unless raw material becomes very expensive at this point?

Lalit Malik: Sorry, what was the first part of the question? What cost increase have we done?

Chirag Shah: So you indicated that the pressure on gross margins, because of accounting issue, where you are unable to mark up the cost increases that have happened in the recent times, where you will not - is that mark small in the volume, and is this the base gross margin we can work with?

Lalit Malik: So I do not know whether this is base or not, but for sure, the technology there, largely ABS-led cost increase that happened towards the end of Q4. The full quarter impact you have seen now in Q1.

Chirag Shah: Okay.

Lalit Malik: And all that is cumulative.

Chirag Shah: Second is long-term question, that traditionally, our Classic was selling also at a price point which was under Rs. 1,50,000 in that vicinity. Now given the way the regulatory cost increases that have happened, that price point has been vacated by our existing models. So any thoughts about launching any of brand in that category at that price point, it could be a smaller CC or a kind of a stripped-down version of the existing products?

Siddhartha Lal: We are working on a lot of things, but we cannot talk about future product. Of course, there are price points that we have had to vacate because of certain reasons and as always, we are thinking about different ways of how to address those customers who may be more price sensitive. So that is an ongoing exercise. And we certainly, we are working on different ideas there, but we have nothing to announce in terms of any new product or anything like that.

Lalit Malik: So although there is price point vacation, but please do remember, over the last 10 years, there have been many new price points also we have created, Rs 1.6, 1.7, 1.8 lacs could be the new price point for the future.

Siddhartha Lal: And just a case in point, I mean, we created a new - I mean, the Twins that is now starting at Rs. 2.5 lakhs. In six months alone, we are now already over half the market for all motorcycles, 500cc and above. So there have been players for 10 years in all of that market. More than half that market, within six months, we are bigger than all the other players combined. Royal Enfield is already bigger than all the other players combined in that market. While we are working on these, we are also creating new price points which did not exist earlier, Rs.2.5 lakhs.

Vinod K Dasari: Not just in India.

Siddhartha Lal: In India, and of course in...

Chirag Shah: And one last question. So how do you decide or when do you decide to ramp up the capacity, now that Twins reached 5,000 units a month? So what do we need to do to increase it to 10,000 units a month capacity? How do you take that call? What are the key trigger points that drive you, the demand is a sustainable and growing demand and hence, we should add capacity?

Vinod K Dasari: Well, at this point, we are not going to suddenly add capacity to double it, but we will continue to find ways to debottleneck the lines and try and see if we can increase our capacity. If the demand continues to sustain like this, which of course if it does, then we will look at it in a few months.

Chirag Shah: Thanks a lot and all the best.

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

Sonal Gupta: Good evening. Thanks for taking my question. Just a couple of clarifications. One was on the financing penetration. I mean, given the increase and given that there is a fair amount of financing dependence, are you seeing any sort of - I mean, like, issue in terms of customers getting finance availability or credit availability?

Lalit Malik: No. None whatsoever.

Vinod K Dasari: In fact, Royal Enfield, I am told has the lowest NPA amongst all automobiles, not just two wheelers. So in that sense, I think Royal Enfield customers do not find that much of a difficulty in getting finance.

Lalit Malik: Banks are more than eager to disburse it, because despite the fact that over the last years, we have grown a bit bigger in areas that are considered slightly more delinquent than some of the other big town kind of areas. Our overall portfolio is lying with the 3, 4 big banks and NBFCs, which continues to be extremely strong. So no problem there. CV is a different story altogether. So we are not talking about that, we are talking about Royal Enfield.

Sonal Gupta: Sure Sir. And just on the demand side, I mean, if you were to sort of break this up, I mean, are we seeing like more slowdown in like the top 20 cities or something of that sort, and this is more like a pan-India thing at this point in time? I mean, any color on - if you were to cut the market any way, and you can draw any inferences from that?

Lalit Malik: Sorry. Just repeat your thing, Sonal.

Sonal Gupta: Sure, Sir. So I was saying that if you were to look at the demand slowdown and try and see, I mean, which are the pockets which are sort of seeing a major slowdown? Or you are not seeing any specific pockets, and it is more of a pan-India sort of a slowdown? I mean, just wanted to get a sense on - I mean, are there specific pockets where you see pressure or bigger cities in general? Or are we seeing things, I mean, whichever way you want to cut it across the board, being weak?

Lalit Malik: I mean, many ways to cut it. Like, you are right. I mean, one of the ways to cut it is the places where our market share is higher than the overall India market share. If you were to use the term of over-indexed over there, then clearly, there is a bit of a stress over there. And these have been historically our key markets where we expanded our distribution first over there, typically, south and west of India. But there is a whole lot of stuff to be done in terms of distribution. And Vinod alluded to the studio stores, which will be towards - from, I do not know, west to east would be a good way to describe them, because that is where a huge potential lies over there. So there we cannot - we do not tend to see any demand slowdown over there because it is still a strong open vacancies of distribution that we plan to fill with our studio stores.

Sonal Gupta: Right. And any number you can share on the top 20 cities, how much of your demand comes from there?

Lalit Malik: Just a sec. So right now, it is 25%.

Sonal Gupta: Okay Sir. Thank you so much.

Moderator: Thank you. The next question is from the line of Ronak Sarda from Systematix Shares. Please go ahead.

Ronak Sarda: Thanks for the opportunity. I have a quick question on the studio stores. You just highlighted something on the regional presence. Can you just elaborate a little more on where do you plan to open these stores? Is it more in the larger states? Or is it in states where we have negligible presence for now?

Lalit Malik: So again, to see India there are so many optics to it; there is SEC ways of seeing it, there are so many other ways of seeing it. But one of the ways you can think about is that till about 2, 2.5 years back or 3 years back, we were largely an urban play. Then we went into slightly more semi-urban, kind of a play. I think, right now, with new stores, we are talking about semi-urban play, to a very large extent. So beyond that, we'll step into what we can loosely call semi rural, the studio stores still do not touch the semirural or definitely not the rural.

Vinod K Dasari: The other way to simply look at it when you do analyze the market, as Lalit is pointing out, just - we looked at all the markets where there are the motorcycle TIV is high or motorcycle market is high and our market share is less. So obviously, the same bike selling in a different part of the country is selling well because there is accessibility to sales and service. So the only reason it is not selling into all those other markets where the motorcycle market is high, people would still want to be aspirational and buy a Royal Enfield, but they just do not have a place. So that was one of the reasons why we said we will focus on those markets where motorcycle market is higher and our market share is less and push the studio stores much more aggressively.

Ronak Sarda: Sure Sir. And the second question on VECV. I mean, can you highlight what is the inventory there? And you alluded that discounts remained pretty high. What kind of range in discounting levels industry-wide discounting level is as of now?

Siddhartha Lal: Sorry, I do not have a number or range of discounts. It is just at, my understanding is it continues to be at the peak levels and perhaps new peaks on the discounting part. So it is the discounting level is very high. But of course, it ranges tremendously from product-to-product and peak discount or average discount, all of that. But it is putting us under a lot of stress in terms of pricing, actually, and that is the main issue here.

Ronak Sarda: On inventory?

Siddhartha Lal: I did not understand the first question, the inventory?

Ronak Sarda: The inventory in the VECV, channel inventory at VECV?

Siddhartha Lal: It is again, it is over 30 days, give or take, but I do not have an exact number. It is not - again, our policy in VECV is to maintain healthy channel inventory. So we do not push excessively with the dealers. We just keep it light. So our focus is always on retail, and that is what we continue to focus on. Of course, a reasonable level of inventory is still required, even in these times, just because of -

especially in CVs, where there is a vast model mix, there is so many different variants which happen there. So you need to keep that level of inventory, but nothing out of the ordinary.

Ronak Sarda: Okay. And one more question, if I can squeeze in, I mean, given the slowdown and the price points which you are talking about, can you highlight what is the mix of single channel and dual channel ABS for us in last one quarter? Is it I mean, customers are preferring more a single channel? Or is it more dual channel ABS?

Lalit Malik: So largely at this point in time, it is only the Bullet which has a single channel. Just everything is dual. But we are not seeing any - and to be honest, we are not seeing any bias between single and dual. So I think people are very loosely I am saying that it is a - people are neutral between maybe single and dual. Of course, they had a big preference when we moved from drum to disc. So that was a big kind of move, but between single and dual, I generally…

Vinod K Dasari: Especially if some customer says that I want single channel, I want only drum. We can do that.

Lalit Malik: That is doable from a technology standpoint, it is very doable.

Ronak Sarda: Thank you and all the best.

Moderator: Thank you. The next question is from the line of Pratik Poddar from Reliance Nippon Life Insurance. Please go ahead.

Pratik Poddar: This is Pratik from Reliance Nippon Asset Management. Just two questions. One is, what is your first-time buyer split and replacement buyer split? That is the first. Second is, generally, you have always been saying premium outperforms the industry. That is not happening with Royal Enfield in the last two, three quarters. Now when I say the industry, I mean the motorcycle industry. So just if you could talk about these two questions. Thanks.

Vinod K Dasari: Existing Royal Enfield customers is 5%. And first-time buyer of a motorcycle is 15% and upgraders from engine capacity, those who upgrade from other parts is the balance.

Siddhartha Lal: Yes. So basically, I mean, from Royal Enfield, we have only 5% customers coming in. So for us, all, 95% of customers are new customers. So that is.

Vinod K Dasari: It is not like somebody is giving back a Royal Enfield and getting a new Royal Enfield, that is - 95% of the people are coming from other parts.

Siddhartha Lal: But what is happened is that over a third of people now coming are from commuter bikes. So earlier, we used to have a majority coming from 150 cc-plus bikes. Now even people directly from 100 cc bikes, around 1/3 of people, from sub-150 cc are coming in directly. So they are by passing the 150 cc and coming directly to Royal Enfield. So that is a great trend for us. And now 15% of people, which was much smaller earlier, are coming, first time they are buying a motorcycle, they are buying a Royal Enfield. So they are bypassing all other brands altogether. So these are healthy trends, continue to be healthy trends for us that we are attracting people from smaller motorcycles as well.

Pratik Poddar: Thank you.

Moderator: The next question is.

Lalit Malik: Moderator, maybe we will make this a last one.

Moderator: Sure, Sir. So we will take the last question from the line of Pramod Amthe from CGS-CIMB. Please go ahead.

Pramod Amthe: This is Pramod here. Two questions. One, you seem to be also impacted by the overall industry demand slowdown on the motorcycles. In case the demand revival happens for the industry, do you expect your products to lead this trend of revival or lag? And what is the reason for the same?

Vinod K Dasari: Right now, when there is a demand drop, I believe, we dropped more than the demand, because ours is an aspirational bike. The minute the market starts to come back, we will go up faster than the market, too.

Pramod Amthe: But any fundamental reasons why it should be the case, than just you have fallen and you will bounce back?

Vinod K Dasari: Because it is an aspirational bike, and people, whenever the sentiment is positive, they choose to look at it. So we also look at the social media and see how many people are interested still in Royal Enfield, how many people look at our web searches and all that. Today, if I saw just the last three months, I think the number of people who actually look for a Royal Enfield in some shape or form at the website is double all of the next three competitors combined. So there seems to be tremendous interest, pent-up demand in Royal Enfield. I think people are waiting for the market to turn, the economy to turn, some positive sentiment. I feel that the market will come back to Royal Enfield.

Pramod Amthe: And sure. Second question is with regard to the regulatory changes. When the ABS happened, you guys did a good job to gradually transform your product portfolio. But having said that, you took much longer time than the peers who were able to do ABS within a quarter, whereas you were sort of almost like two, three quarters. So similarly, when it happens to BS-VI, would you be similarly cautious to transform your portfolio? Or do we see different behavior of yours to be moving to BS-VI much faster?

Siddhartha Lal: Well, the only absolute truth is that by March 31, we should have zero BS-IV. So that is the real transition plan. Because, I mean, of course, the transition will start happening well earlier than March, but there will be a lot of different factors that play up. So we have to be on top of that, and we are going to make sure that the main transition will happen in Q4. We will not do an enormous transition before that. So the main transition will happen in Q4 between January, February, March, where we will start ramping down BS-IV and ramping up BS-VI. So that is when you'll see the entire transition happening.

Pramod Amthe: And the last question, if I can ask, considering the aggression with which you are planning to expand the distribution. If I had to look at others who have done the same in the two-wheeler industry, it leads to much more price undercutting by dealers or discounts and all these trends, which emerge, how do you see that? And how do you plan to put a control on it, as compared to what you have achieved in the past?

Lalit Malik: Pramod, you have been tracking the company for far too long here to ask this. It is our dealer management system through which the entire billing, the - I mean, the entire sales funnel is managed through our own billing, for which we have real-time information flowing through. So we have full visibility about the price a dealer is charging.

Pramod Amthe: Thanks.

Moderator: Thank you very much. We will take that as the last question. Ladies and gentlemen on behalf of HSBC Securities that concludes this conference call for today. Thank you for joining us and you may now disconnect your lines.