"Nelcast Limited's Conference Call"

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MANAGEMENT:

MODERATOR: **MR. SUMANTA KHAN – FUND MANAGER, RELIANCE NIPPON LIFE INSURANCE**

Sumanta Khan: So, sir, we will talk about Nelcast, but let me just tell you something about myself, I ran out of my card, so I have not been able to give you.

Management: Sure.

Sumanta Khan: My name is Sumanta Khan. I'm working as a fund manager with Reliance Nippon Life Insurance. We are a life insurance company. Nippon owns around 49% of this company. We manage roughly $1 billion of equity. And across, I think more than 40 odd schemes. This entity has been here for a long period of time. And I joined this company last year. Before that, I was with ICICI Prudential Life Insurance. So, there I worked for more than 13 years. And before that, I was with Morgan Stanley. So, I've been managing funds since 2013. This is the ninth year. And between 2008 to 2020, for 12 years, I was an auto analyst also because there we had dual roles, right? So, I learned a lot of things, interacting with people in your position. And I think most of my learning has come from there itself. So, I'll just start by, I think a lot of the discussions which I overheard out here, right, very frankly speaking, it's the questions for a company of your size and structure is somewhere around similar levels, right? So, I was just going through a con call transcript. Roughly 160,000 tons capacity and 128,000 tons, 130,000 tons is probably the maximum that you can do from this kind of year. You're earning roughly I think Rs. 129 to Rs. 130 per kg kind of average. And last year, Rs. 12, Rs. 12.5 per kilo would be your EBITDA.

Management: It will be less for the whole year. For the fourth quarter, it was at about Rs. 10.5, but we believe this year will be about Rs. 12, Rs. 12.5, and variety of reasons. Last year was what it was.

Sumanta Khan: I think the most important is last year you did roughly79,000 tons, 80,000 tons of sales of production right?

Management: Last year it was 72000 tons, 71,9000 tons.

Participant: Dispatch is 72,000 tons.

Sumanta Khan: I wrote it down.

Management: 71900.

Sumanta Khan: Which is roughly 56% kind of utilization. So, obvious question to anyone out here is that over the next 2, 3 years, how do you see the path towards higher utilization levels, roughly touching 170. What I could again get from your con call is that around 37%, 38% is from the truck side. Something around 33% would be tractor, and the rest is exports and something else probably, right? And so, just if you can take me through, I mean what gives you confidence that, because you're also parallelly going for another round of expansion, right?

Management: No, just modernization is what we did.

Sumanta Khan: You've done completely or you will do.

Management: There was expansion in 2020, we completed.

Sumanta Khan: So, no further expansion --

Management: No further expansion.

Sumanta Khan: -- at this point of time, okay. So, just take us through was there was lot of drivers, if I see exports of 75% growth, these are very, very strong numbers. And what I understand a little bit of what to, overnight these things don't happen, right? They take lot of lot of effort.

Management: I really appreciate you saying that, right? Because whatever numbers you're seeing today's is efforts we started in 2013.

Sumanta Khan: Yes, I'm sure these are long –

Management: I appreciate your understanding of my point, right?

Sumanta Khan: Yes. So, just a broad sense.

Management: So, I'll just kind of go through. I know I've talked about the numbers already in the con call, right? So, if I look at medium and heavy commercial vehicles, last year, we did about 36% odd came from medium and heavy commercial vehicles, about 36.7% growth.

Management: This is domestic M&HCV?

Management: Domestic M&HCV. So, this domestic M&HCV, what we are seeing currently and what we're hearing currently, and we're seeing it very much in terms of the demand we're seeing in the current quarter is we believe that we will see at least a 20% growth that will happen in the sector. We believe we can beat the sector growth for a couple of reasons. One is related to -- we think there's going to be a good amount of infra spend that happens this year. From what our understanding is last year, there was a good amount of infra spend allocated in the budget, but unfortunately, because the second wave of COVID with Delta, a lot of that money had to be utilized for more pressing needs in healthcare as well as expansion of the vaccination program, right, which were all worthy causes and so we can't complain about it. But certainly this year with the allocation that's made, if they're able to spend it and utilize it and build the kind of roads they have to build, we believe the sale in the infrastructure segment, right, which is primarily tippers will grow. Now there are 2 things that happens if the sale of tippers grows faster than the overall market. One that's going to happen is the quantity of castings per vehicle in a tipper is higher. Because most of these heavy-duty tippers have 2 drive axles, they have a bogie suspension, they have much more beefed up heavy bigger engines, all these type of equipment that are part of these. So, we believe that that will happen. And if that happens, our share of business within our tipper is also higher. When I say our share of business is higher, that in a typical haulage vehicle, there is 1 rear differential carrier, average weight may be somewhere around 60 kilos. And we have maybe 65% of that market. Now if you take a heavy-duty truck, there is a forward carrier and a rear carrier. The rear carrier is still the same 60 kilos, we still have 60% of that market. The forward carrier is actually 75 kilos, 80 kilos, and we have 90% of that market, right? Maybe even 95% of that market, right? So, that's one component, right? The other part is also the bogie suspension bracket, right? Bogie suspension bracket doesn't exist in all these other segments, but it is used where these heavy-duty tippers are.

Sumanta Khan: So, if I go back on the heavy duty, roughly 150 kgs is the total --

Management: I'm talking only about differential carrier alone. Yes, it will be about 140 kg, 150 kg.

Sumanta Khan: You will have something like 70%, 75%--

Management: Versus 60 kg and 60%. So, that is one thing that we believe in the years to come, India will increase its infra spend, the number of these tippers required will grow faster than the overall industry and I think that is something that will help us growth, right?

Sumanta Khan: I talked to you. You said haulage, heavy duty, you were talking about one more. So, I just stopped you in the floor.

Management: The third one, yes, I was just talking about the bogie suspension, which is used in the heavy duty, right? So, there's another thing called the bogie suspension used in the heavy duty. So, when you've got these two drive axles –

Sumanta Khan: Bogie suspension, you were saying, yes.

Management: Yes. So, the bogie suspension is used between the 2 axles to ensure better power distribution to the wheels. So, in a normal vehicle, let's say for example, Tata Motors, we don't do suspension brackets really for Tata Motors. But when it comes to bogie suspension, we are their 70% source, right? And each vehicle that has this, it's of 150 kg per truck for Tata Motors, right? Similarly, actually, Ashok Leyland in their new vehicle, it's actually a 380 kilo component, right? So, there's an opportunity that's there that will come from one, we believe this overall industry is going to grow 20%. We believe that growth in tipper will be higher than that industry growth, right? And if that happens, we believe our growth will outpace, yes, the growth rate. So, that's why we're very confident on this M&HCV space over and above whatever industry confidence is there, right? The second part is tractors. Tractors had a bad year last year, right? And it's a weird way to say that because we're talking about a degrowth of something like 5%, 6%, 7%

Sumanta Khan: That was a decline of more --

Management: From a record year, right, where the growth was 25% and suddenly degrowth 5%.

Sumanta Khan: And only 6 months, again it's back to --

Management: Yes. So, currently, this year, we are seeing very strong demand from tractor, right? This is something that we believe will remain strong, right? So, one of the things, right, I was actually with our largest customer a couple of days ago, TAFE, right, and what they said is there are about 11 economic indicators they track. So, this year, every single one of those levels seems to be positive. But they were still a little apprehensive because of commodity pricing, the price increases that have gone through whether it's because of inflation, there will be a hit in demand. Fortunately, they're not seeing that, right? But they're saying, whatever, those 11 indicators that they typically track, all of them seem to be positive, ranging from mildly positive to extremely positive, right? So, tractor seems like it's got a good year ahead. Everything from water level, forecast of monsoon, political situations, availability of credit, when I say 11 indicators, right, these are the things that I'm talking about, right? Water levels, as always, I think I already said that. So, tractors seems like it'll have a good year this year. In terms of production volumes, right, we get information from our customers, right, all of our customers, we're seeing that, at least for each one, all of them have put together their production plans, which seems to be 10% higher than what it was in H1 of last year. That's what they're projecting as project production plans, 10% higher than what they produced last year in the first half. And last year first half, they produced a lot, they ended up with a lot of inventory and that's why second half, they really cut their production numbers, right? So, they cut their production by 50% in the second half last year. Now they don't have inventory. So, now it's the other way around, right? But one of the variables seems to be in tractor, as I'm learning is the festival sales. There's a lot of sales that happened during the festival season. So, a lot of these guys build up their inventories in anticipation of festival sales expecting either a good year or a bad year. And depending on what actually happens, the second half of the year really comes into picture, but so far, with whatever indicators are there, whatever we're seeing, whatever we're hearing, we think tractors is going to have a good year, that's what we believe and that's what we're working towards. In terms of exports, right, I think, you already brought it up. We've got 7 new products that are going to get launched in this current financial year, right? One is on GM's Chevy Colorado, I think it's the GMC Sierra, that's the same platform, we're going to be supplying the rear differential carrier for all of those vehicles. So, it's about a 20-kg kg part or so that we're going to be supplying to GM in US. It's not to GM directly, it's to the American Axle who will assemble the axle and supply it to GM. So, that's one product that we've got that we'll be launching this year, so that goes into production at GM's plant in January, right? At least that's the plan for now. I don't see any reason why that plan would change, but that's what it is. In addition to that, the Ford Super Duty. So, the biggest of the biggest, Ford pickup trucks that you can get is the Ford I think F450-550 series. So, on that one as well, we're going to be supplying the differential carrier on. We've got some share of business increase that's happening with our customer in Detroit Diesel, very shortly. We've got a new product launching with Dana, that will go into class 8s. So, we see the US market as strong. We've got new products coming in. We've got a new electric vehicle product for a GM BrightDrop delivery van. In fact, their annual production capacity is 30,000, they've already got 30,000 preorders. So, that again goes into production in January at GM's plant in Canada.

So, this is a new product, again, new product, new space for us. So, we are quite excited about it. And we believe there's another product that will get into their next electric vehicle that's getting launched in 2024, which is actually a much more substantial business for us, that will get into production again in GM Canada in January 24. So, we've got all this pipeline of business. We've got some parts as well, which are currently being sourced from China being redeployed to us, resourced from us. So, there's a variety of things that is happening on the export front where we believe export growth at least what we can see with our horizon, all these products that we're launching today, everything, these were things that we saw -- many of these were things that we saw probably 2 years ago. And so we've been preparing for this and getting ourselves ready for this. Suddenly, we're getting a lot more opportunities now. And some of the opportunities that are coming up now seem to be products that can get launched within the next year, right? And in some cases, our customers are pushing us to say, can we launch within 6 months? So, I can't say I have full visibility, but certainly the visibility that we have today, we believe we can go from -- last year, if we look at, we did about, let's say Rs. 55 crore a quarter. We believe we can do exports of about Rs. 100 crore a quarter by the end of the financial year. We think we can get that kind of a growth rate, right? We're not going to average 100 for the year, but we can get to that rate, by the end of the year. So, I think that's going to help us drive growth. The other one that's there is of course, maybe, I don't know how significant in the off-highway space. There's a forklift front axle product that we've developed. There're about 7 models of these. This goes to end customer as Hyster-Yale in the US who makes the forklifts. And these are going on again in their next generation models. So, the date of production, they should have actually already been in production. But they've had supply constraints of other parts. So, they're still continuing with their old range and they haven't yet launched the new range. So, when they do launch the new range, we'll see that ramp up as well, quite a bit, you can see that product right in the middle at the bottom, the forklift steer axle. So, that's the other thing, right? And so we believe these are the things that are going to help us really drive growth over the next period of time. The other one, right next to the forklift drive axle is that 4 wheel drive axle housing that you see next to it, right, and then monolithic above it. So, these are complete axles. We didn't have the capability or capacity to make products of this size until end of 2020. So, then once everything got done in 2021, we spent a lot of time developing new products and all of that. So, that photograph of the green part that you see over there, right, that's actually used in a John Deere tractor, that's the front axle of the 4-wheel drive tractors. So, prior to us developing this part, these parts were all imported into India from China. So, today, they are manufactured by us, assembled by our customer in India and then shipped to John Deere plants all over the world, including Augusta, Georgia and the Augusta in the US as well as in the plant in India. Similarly, there are parts like that that are used in -- so we've developed also recently 4 parts for another customer, Carraro. It’s an Italian company with a manufacturing base in Pune. So, they also do these type of axles and supply to customers in India and around the world. We've developed it for them. And Case New Holland is another CNH, right, they are the large tractor manufacturer, I think probably the second or third largest tractor manufacturer in the world by revenue, _not by volume; of course volume, Mahindra is number one, I think TAFE is probably number two. But because India we have a lot of smaller tractors, low value, but quantity is more. So, CNH also, we've developed 2 of these axles, they're currently under testing. Once those 2 testing is done and approved, there's 5 more that are in the pipeline that will get tested, that we have to develop tools for, manufacture, give them for testing, get the approval and the spread. So, we'll have even domestic some additional new parts that will come in. That particular photograph you see of the one where it says monolithic axle housing about the forklift steer axle, that one is actually going in product as JCB vehicle as well. We supply to the axle manufacturer which is Dana, they make their axle and supply. So, for a product of that size, there is really nobody else with the capability to do it in India, right? Certainly not in a cost effective manner because there's a very manual high cost way of doing it. And typically for the more automated low cost way of doing it, the size has always been the constraint. So, we're the only one who has something of the bigger size, but with this process, and that's something that's very unique, I would say in the industry. And there's maybe only a handful across the world that can do something like this.

Sumanta Khan: So, basically, you're saying that yours is not a highly automated process, right?

Management: Ours is automated. So, we are able to use the highly automated process for doing something that somebody else would have to do in a very manual process. See, there are parts of a process where we still need to automate that are manual, but the core of it which is producing the molds and pouring the molds, we have moved to an automated process over the last 10 years or so. So, 10 years ago, we had 10 manual lines and 1 automated line. Today, we have 6 automated lines. And part of the reason what this automated lines has given us also is that ability to go capture complex products and exports. If we did not go into complex products and we were doing no complexity products, we would have been competing with Chinese companies. And we would never have been able to break through on the export market like we did, right? So, that's been our I think ability to capture whatever we have done over the last 10 years.

Sumanta Khan: Throw some more light on this China angle because when you talk about China plus strategy, it's mostly to do with textiles. It has more to do with chemicals, right? India as a growth story either has been more domestic, right? Or the MSME trucks which few of the bigger players in this industry do. But I think this is the first time I'm talking to someone who's talking about this shift of base from China. What it is triggering because, given the scale of China, this was never a very lucrative positioning for India.

Management: So, just quick numbers, right? If you look at casting industry and when I say casting, total casting like gray iron, ductile iron, aluminum, everything, right, you add everything together, China does close to 40 million tons. India is roughly at about 12 million tons, right? India and US are, when US has a very good year and India has a bad year, US is number 2, otherwise India is number 2, right? So, roughly at between 10 to 12 is where India and US have been if you look in the last few years. China has been somewhere between 35 and 40, so just to size the market up. Now, I'll just tell you a little bit about in terms of what we have felt about the Chinese producers, who we've were competed against or whatever, right? In most of the cases, we've seen where the Chinese producers are able to do well, is where there is low complexity and perhaps pretty good volumes. We have seen the Chinese being very competitive, competitive to a point where you don't even understand how costs itself are matching, forget margins, right? So, these were the head scratching evaluations that we did. But nonetheless, that's how it was like. In 2015, we had a Chinese competitor that quoted some business that we had also quoted at that time, we hadn't won the business, we had just submitted a quote for the business. So, the Chinese supplier actually quoted 17% lower than what we had quoted, a substantial amount of money, 17% lower. So, they had to make a decision. So, we had a technical review with the customer. Our technical review was 3 products. Our technical review with the customer took us 2 hours, we didn't finish it, we had to schedule another hour the next day to finish it. So, 3 hours we spent on technical reviews. We went through every single detail of what they wanted, how we were going to do it. If there was a problem and certain things we could not achieve, we went to the point of being able to show them how the metal is going to flow inside the mold, how the solidification is going to happen and why we feel confident that we can meet this standard or why we feel there is a risk, we may not be able to meet some standards. We also took them their own 3D model what they had given us, their own 2D drawing, which was a legacy 2D drawing, did a comparison and told them Hey, there are differences between what you have said you want in your 3D model and what you have shown as the dimensions in the 2D drawing. How would you like us to proceed? So, this is what we did. Three products took us 3 hours to go through. The Chinese supplier, they had the same technical review with, 30 minutes, it was done. They said yes, we'll do it. That's it. That’s literally how that technical review meeting went with the Chinese supplier. So, the guys in the engineering purchasing who are part of this meeting, didn't feel confident of being able to say, let's go with the Chinese supplier. So, what they did in reality was they took to the 2 parts, which were high volume, high value, and said we need cost savings from our US supplier because it was being resourced out of their existing US supplier. We need cost savings. Let's give it to Nelcast. There's one part where the volumes are lower, there's actually a little bit more product complexity in that particular part this thing. Let's give it and see if this guy is capable. Six months later, we were in production of the first part; 9 months later, we were in production of the second part into serial production. That Chinese supplier took 4 years, right. And suddenly, 4 years later, had a 25% import duty that Chinese supplier is no longer competitive. So, they're not really doing much with the Chinese.

Sumanta Khan: This is the Trump era import duties that are --

Management: Exactly. And everybody was thinking, Biden will come, somebody else will come, it will go away, some deal will be there. So, in the initial day, somehow they were buffering it, right? They went to the supplier, said, you take some, I'll take some, all that stuff. Now it seems to be clear nobody wants to touch it. So, that is one case. Now the second case which I'm here -- so this is historically, right. So, if you look at our export growth, right, even prior to this Trump era things, how have we managed to do, it's because of complexity and product complexity. We were not really doing any parts that were so called simple parts or simpler parts in the scale. Now coming to most recently, we have a part that I would consider to be one of those simple parts currently being manufactured in China. Volumes aren't great, but still decent volumes being manufactured in China. The company wants to resource some of that volume away from China. So, there's a couple of things that are there. One, of course, they're getting hit with those duties, Trump era duties. The second part of it is, they don't find the Chinese market to be very reliable. And when I say reliable, I mean, in terms of casting, right, the kind of investment that we make, in terms of pollution control equipment and all of that, right, because you've got hot metal, and then you're dealing with a lot of sand, right, which has a natural tendency to try to fly in the air. So, they've had situations multiple times in the last few years, where the pollution control authority just comes, shut down the factory during the winter months. And they don't know when it's going to reopen. Fortunately, they've been able to manage it without any disruptions or any major issues. The policy in China seems to be a little bit --

Sumanta Khan: These substances are there everywhere in chemical and also its associates. So, basically, clearly there is a shift. One is taxation --

Management: I think there's also a growth of the residential area close to that industry. So, apparently, the industry is saying, listen, we're going to close this factory down and move it 300 kilometers inland. And so these people also, the customers are also not very happy with this thing. They're concerned about further disruptions. So, I think this is the first case where we are going to be -- I believe it will happen, right? The reason I believe it will happen is we've received a letter of intent. It's not a great deal of business, but it's the first time that we're actually seeing some business coming from China to us. And if you had asked me 2 years ago, I would have never imagined something like this happening. Actually, if you'd asked me 6 months ago, I would have never imagined something like this happening. But I think there is a certain geopolitical angle to China as well in addition to that.

Sumanta Khan: Yes, there is an angle.

Management: So, I think people are trying to hedge their bets for that geopolitical reason. But in this particular case, it's also a little bit more pragmatic in saying that the supplier is not reliable. And prices are almost coming to same level, right?

Sumanta Khan: You're able to compete on the price front you were saying?

Management: Yes, obviously with that 25% duty on, we are.

Sumanta Khan: With 25% duty, definitely is tilting the base towards. And do you think this can accelerate? I mean, you know, 40 and 12. Because see, even if, let's say, 2 million tons move away from China, that's hardly 5% fall for them. But it's almost like a 15%, 20% jump for us, right, as a country, right? And if everybody gets a fair share, then it's quite a good volume for us, right? So, you think this 25% tax regime can incrementally push all you think there are further barriers for this?

Management: I think it can push. I would have said that some of those really low cost, high volume things that China was doing, the US would also be able to do it, because when there is no complexity, you don't need people, you can automate it and do it, right? When there is complexity, you can't, right? And we don't have, crazy volumes, so it's really difficult to do that. So, I think, now it's US with their own labor shortages with people not really investing in foundries. There has not been, to my knowledge, not a single Greenfield foundry in the US that's come up in the last 20 years and probably the number of expansions that have happened at existing facilities, right? If you look at it who are the people who have expanded, we’ve done major expansions, right? This guy is like a John Deere who are doing it for captive purpose. I've not really seen big amount of investment in the US because of some of the OSHA rules that are there regarding workplace safety and things like that. So, there's I don't foresee also substantial investments happening in the US going forward for that reason. But the competitive landscape in US has changed a little bit.

Sumanta Khan: US is currently, I mean I'm just focusing on moving from China to India and if that happens, then clearly for the industry per se, this is a good growth opportunity, I mean, domestic business in itself is we are in a what you say in a cyclical positioning, we are possibly in an upcycle, right? But if the China to India happens, it can be a tailwind for the sector for next 2, 3 years, I mean if not more.

Management: It is a very fragmented industry, but as fragmented as the industry is, if you were to ask me you take a global OEM, right, the quality of a Daimler, a Meritor, or Volvo, Dana, you take the American Axle, GM, you take these kinds of OEMs, and you say, how many foundries in India can actually cater to them? And I think you can probably count those on 2 hands, right, less than 10, perhaps only half a dozen or so. In fact, I have a customer right now, who's already sourcing parts out of India, who's looking at creating a second source within India for the same part, because they have questions on the financial strength of the company that they're working with, right? So, they're saying, okay, even in that 10, there might be a few that that people might not even be comfortable working with for different reasons. So, I think that way I feel quite excited about one, the opportunity for India. I think India as a whole, we are placed in a very strong position. But I think within that especially when it comes to products of ductile iron, I think we've got a lot of opportunity in front of us, and we are probably the prime candidates to jump on this opportunity that might come to India for these types of products.

Sumanta Khan: Next question which is very obvious with your organization is on the return on the capital employed, right? I mean, you're doing very well, right. You have very good growth profile, right, margins. See, one, it is 56% utilization. So, if 56% goes to 80%, then definitely your EBITDA margins should improve, right? It may also be because last year was very tough for commodities. So, we don't know how much gets passed on, right? But clearly, I mean mid-teens kind of ROCE is where you are actually generating enough to compensate for the risks you're taking for being in this business, right? So, obviously, the questions which people might have, somebody has a high single digit ROCE is that is it structurally the business and the parts, you're showing me parts, which are very complex, right? And typically, in casting and forging, if you're managing complex, if you're not forging, but also machining then obviously, margins, ROCEs, the investments go up, but so do these factors. So, I mean, how do you see that journey from here on in the next 5 years?

Management: So, I think ROCE is going to improve and improve substantially. Here's the reason why I think that. I think one, if you look at kind of what our numbers and our journey has been, like, I think that movement towards complexity and adding more complexity is something that is more a product of what started in 2013, right?. So, the product mix has changed quite substantially from where we were previously to where we are now in terms of complexity. So, if I look at what happened really in the last couple of years, right, which has really hurt the ROCE numbers. One is we made a substantial investment in this new capacity and capability, which added a lot of capacity, but we could not utilize the capacity, right? We could not utilize the capacity partly also because one, we had projected industry growth will be better than what it was in the last couple of years. And we believe the mistake that we made, right, in terms of projecting industry growth is this axle load norms, which we could not have foreseen when we decided to go ahead with the project, because when we started, we went ahead with the project in 2018. So, by the time it got ready in 2020, the axle load norms had come in. So, the axle load norms really had a big impact on the commercial vehicle space, right? I think if you look at some CRISIL or ICRA numbers that are here, right, so it went from basically in financial year '19, 3.9 lakh M&HCV down to 2.2 lakh, right? So, it was a pretty big impact that we saw, because of this regulation change by the government. And to be fair, we could not have foreseen it. And we are already committed to this project prior to that, and we were I think beyond a point where we could pull out of that commitment also, right? So, that added that additional capacity to come in and all of that. And in the meantime unfortunately that --

Sumanta Khan: Rs. 200 crore you spent in 2 years, right?

Management: Yes. In 2018 to 2020, yes. So, there was a substantial investment that we made. So, that added capacity, now we've got to utilize that capacity. Second part is now with adding that capacity and one of the reasons we decided to go ahead was it was not just adding capacity, it was adding capability. So, these products that you see here, right, this axle, this component, there's another version of this that we supply to Ashok Leyland which is about a 380 kilo part. So, these products are all products that we've now productionized only in the last several months because it takes time to develop the products in a new line and be able to go through testing, validation all of them. Now, I don't believe we'll need to do any addition of capacity in the next year or two, right? Our objective for the next couple of years is to fully utilize this capacity before we look at making any further investment, right? So, unless we see that roadmap that within the next 6 months, our capacity is going to be beyond that 125,000 tons, we are not going to look at adding capacity, right? So, -- but in this particular case, this line being so unique, we've never done these products in our life, right, these 4 wheel drive axle housing, this is the first time we're doing this. These off-highway axle housings are first time we're doing it, a 388 kg part, right, what we're doing for Ashok Leyland is the first time, we're doing a part of that size, right? So, there is a learning curve on our side. And that's part of what's showing up here, right, is the ability to develop the parts, go through testing, go through approval, and get to and then start ramping up the volumes. And at the same time, capacities got hit quite badly, utilizations got hit because of this, axle load norms that came and even the tractor had a pretty good year in 2021, it was slightly down in ’21, ‘22. So, that's kind of what drove us a little bit in the past. As I look at the future and our focus right now is how do we bring up capacity utilization? How do we execute on the new businesses that we already won which are getting into launch? And we believe that is when we get to good capacity utilization, what we would be doing differently this time, right, when we look at expansions is we would actually be not looking at adding capability like this, right, because this is unique, this is a one-off, we would be looking at saying how can I replicate my existing plant? So, that to the tune of saying, can I use the same tools, so I don't have to spend time, money, effort in terms of developing new tools and validation time, right, it saves a lot of these things. So, while I don't see that we will be adding capacity in the next couple of years, I hope I'm wrong, and the demand grows so much that that I'll have to eat those words. But in future when we do add capacity, the way that we will add capacity is so that tools from the existing lines can be utilized in the new line. And that way, we can do much faster ramp up of this thing. And the approval cycle also gets a lot easier. So, this is a unique case. But in this particular line, right, with these products, like I said, we've not done these products before, and we now had the capability to do this product, so we've now developed these products. Then we had to go through the approval process, then the ramp up process. Unfortunately, we also got a little bit unlucky perhaps.

Sumanta Khan: In 10-15 years cycle, these things don't matter, right? What matters is, what is happened over a longer period, right? Even in good years, you've been making low teens kind of ROCEs, right? So, one angle I saw is your asset turns is around 1.2 to 1.6 times. Do you think that is good enough or you think that can go up?

Management: I think we should be able to get that beyond double that, I think we should be able to double that right, as our capacity utilization goes up.

Sumanta Khan: So, currently it is 0.7. So, as we go up, your capacity utilization is there's a new plant. And so I'm talking about, let's say FY10 to FY16-FY17, if you look at that period, right, you had years of 1.6, you had years of 1. -- so average 1.3, 1.4. That is the kind of asset turns you can generate?

Management: Yes, a number above 2s is a very reasonable number, I think we can generate, right? So, one of the reasons, right, when we took exports as a focus in 2013 and started moving in that direction is also the volatility what we see in export is substantially lower than what we see in the domestic market, right? When we talk about M&HCV here, the kind of numbers we’re talking about is suddenly one year it will drop to 23%, one year it will grow 40%. These kind of numbers, we see it here. Let's take the class 8 market in the US, right. 280,000 people are normal, 240,000 everybody's running around crying the world has fallen apart, right? We're talking about hardly 10%, 15% drop, everybody just completely feels like the market is in such a horrible space. 320,000, everybody is jumping up and down in joy. Similarly, you look at, we’re getting into this passenger vehicle space, right, like vehicle space. There 17 million vehicles a year is normal, right? If it drops below 16 million, everybody thinks the world has collapsed, right? If it goes above 18 million, everybody is jumping up in joy. So, 5% is what they consider high and low which I think in 2009, 2010, when the market had dropped to 14 million, there were the entire auto industry was in distress. So, one thing we believe, there is some amount of cyclicality that's in M&HCV, we can't take away. But with the tractor also being a substantial portion, there is some cyclicality in that that could potentially cover this. We believe exports is the other one, right? So, we're trying to take cyclicality away as much as possible and make it -- obviously, there is going to be cyclicality but try to at least buffer the lows, right, so we don't get the bad years that we've seen in the past.

Sumanta Khan: That's the complex parts, will your realization per kg will go up. So, that itself is a very good driver, right? So, this, 129,000, 130,000 that you have now, this is a mix of few of the erstwhile autos, which are low and probably the new ones which are high. So, you think that can grow as your utilization level goes up, the more parts, the more orders coming from replacing China?

Management: So, the one thing we’re were looking at that, that we have to also keep in mind is this raw material pass through that's there, which goes out to the top line and the bottom equally, right, because we're passing it through. So, I'd like to be able to tell you, we're going to do fantastic asset turns, which, with today's raw material prices, without significant investment, we could probably get to, Rs. 1500 plus crore kind of a thing which we will put those asset turns at 3+ kind of --

Sumanta Khan: That would be because of inflation, not necessarily because of --

Management: Exactly, right. So, I don't want to throw those numbers at you right now because then suddenly if inflation continues on this pace, that number will look even better if inflation it deflates with raw material prices coming down, then you'll ask me what happened to your asset turns. So, I want to be upfront with you on that. But the realistic thing is, I think our margins are going to improve. On the cost front, from an efficiency standpoint, as our utilizations improve, obviously, fixed cost absorptions, all these operating leverage things start kicking in. But other than that, what happens is, let's say, for example, in a furnace, you're melting 100 tons a day, you may be using 700 units a ton of electricity to melt that. When your efficiency improves and your output improves and you're melting 110, suddenly you're not using 700 anymore, you might use 690 or 680, right, because you become more efficient at using the melting because you're not holding the metal for as long. As soon as the metal is melted, you're pouring it rather than spending energy to keep it at temperature or things like that. So, there's a variety of things, right. So, as you become more efficient, so there are these, pseudo variable costs that actually become better, right? The other part of it is electricity, right. So, you've got a maximum demand that you are paying every month no matter what, no matter how many units you consume, and then there is a variable portion of it. So, that maximum demand is fixed. But the variable is really -- the energy cost per unit cost is variable, right? So, if you can get more out of a certain fixed demand, that's one of the things we're working on. Similarly, and then also on the energy side purchases, right, so about 55% of our power that we're getting, we're getting it from renewable sources, all of these are through group captive arrangements. So, we've made some investment in that SPV, and we are contracted to buy certain amount of power at a subsidized cost compared with the board price, right? So, these type of things we're doing other than the usual cost reduction activities everywhere with like, we're doing productivity improvement activities, all of that stuff is all going, but in addition to that, this is something that we are working on. So, on the cost side, this is what is. On the product side, right, I mean more complexity, right? It gives us an edge in terms of the business we can win, hold and charge a little bit more of a premium, right? We do have components today, right? Even if I strip out the freight cost and I strip out any machining, value addition that we're outsourcing, all these things if I strip it off, there will be products today where we're making probably, Rs. 140, Rs. 150 a kg, the products in that range also, right. So, it's all a question of the ability I would say in terms of the market….

Sumanta Khan: The execution. So, currently you're saying that how you execute and move from the 70,000, 72,000 tons to 130,000 tons.

Management: Yes. Volume is very important for us. So, we see this year, right, with the reasons that I told you, right? Our M&HCV doing well, we think tippers is going to do well, we think our share is going to go up. We think tractors is going to do well, with all the export launches that we have. I think we see that roadmap to get from about 70,000 tons to somewhere maybe about 1 lakh tons or so this year, right? So, we think that that roadmap, we're able to see it, right, obviously depends on the market still, right, because where it's not driven entirely by us, and how the market does, but we see that opportunity right in front of us this year to be able to move in that direction.

Sumanta Khan: I think a very good discussion we had. So, thanks a lot. See, I think, today, where India is right, I think it's very important that we have a slightly longer-term view. Your quarterly con calls are fairly detailed, right? So, obviously, I thought, I'll just have a broad sense where you want to head as a company, I think that is more critical at this point of time.

Management: Yes. Like I said, I think domestic we've got a good position in the market. We don't want to let go off that, we want to build on it and get stronger. But I think in the export front, we see great opportunity. One of the things that we're seeing right now is a lot of interest coming in from Europe. Still a little cautious, but we think it's going to accelerate in a few months, because energy costs in Europe has gone up.

Sumanta Khan: That is also a big driver, because the way this Russia-China think is going on, that is another strong wave which is -- what has happened is the actual demand itself has taken a beating.

Participant: Sir, can we wind up?

Management: Yes, sure.