"Hero MotoCorp Limited Q2 FY2020 Earnings Conference Call"

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Moderator: Ladies and gentlemen, good day and welcome to the Hero MotoCorp Limited Q2 FY2020 Earnings Conference Call, hosted by Antique Stock Broking. 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. Priya Ranjan. Thank you, and over to you, Sir!

Priya Ranjan: Thanks, Ramel. It is our pleasure to host Hero's 2Q results conference call. Now I will hand it over to Umang to introduce the management team and move ahead with the conference.

Umang Khurana: Thank you. We have with us today Niranjan Gupta, CFO; and Sanjay Bhan, Head of Sales and After Sales. We will begin with an introduction, the first comments from the CFO, and then we will open it up for your questions.

Niranjan Gupta: Thanks everyone for joining our call. You would have seen our results. You can see that the Q2 results in general were impacted by the overall slowdown in the economy and of course auto sector in particular. Having said that there are some significant positives, one, overall on domestic motorcycles we gained market share in Q2 as well as on YTD basis, secondly, the premium launches that we have done are picking up and that is also reflected in the market share though it is a long way to go, but we are on track, and third, the EBITDA margins have been maintained sequentially despite the adverse topline.

Moving forward, the festive seems to be showing good buildup. Versus a double-digit retail decline in the industry and our own portfolio in the six months preceding the festive, we are seeing a positive growth in festive, which is a good sign, albeit the growth is in low single digits so far, but still a very positive sign given that the negative momentum, which was there seems to have been neutralized and arrested. There are a couple of tailwinds moving forward in the short term. Lot of rains that India has received, while in few parts there may be a short-term damage to some of the crops, but in the medium term it increases the water reservoirs and water table, which means that the crops moving forward have sufficient water and therefore there should be a positive reflection of this moving forward from rabi crop onwards.

The second tailwind is of course the expected pre-buying in Q4, because as you would have seen some models have already come into the market on BS-VI, which have a price increase of around 12% to 15% and obviously that quantum of price changes should trigger some pre-buying in Q4. Having said this, a sustained recovery in the short term may still take some time, but we do remain optimistic about the long-term future for the auto sector, given the under-penetration and lot of opportunity that exists. This belief is also reflected in our continuing investment behind new launches as well as the Andhra project, which we continue to move forward with and finally our BS-VI is on track and you would soon see our launches coming up post-festive. So with that, we conclude the opening comments, stating that in the short-term, some tailwind recovery may take some time, but in the long term we are optimistic. Let me hand over this call for Q&A.

Moderator: Thank you very much. The first question is from the line of Kumar Rakesh from BNP Paribas. Please go ahead.

Kumar Rakesh: My first question is around gross margin which you reported during the quarter, so sequentially almost 200 basis point gross margin expansion we have seen despite sharp decline in the wholesale volume, which you have reported. This partly could be led by the production, the factory inventory buildup, which we have seen during the quarter. Going into the December quarter and that being the model year change quarter as you most likely would be winding down some of these inventories, and also at the dealer level, the inventory, which would be running that also could be coming down, so are we looking at the December quarter where the production could be sharply lower, and hence these level of gross margin may not be sustainable going forward?

Niranjan Gupta: Thank you for the question. We do not guide on quarterly margins. What we do is that we keep applying various levers of margins, which of course include cost optimization, sourcing, the LEAP program, optimization on other expenses, portfolio, etc. It is a combination of various things and the tactics and the strategies that we adopt from quarter-to-quarter and that is how we expect it moving forward as well.

Rakesh Kumar: Rest of the 2-wheeler OEMs who have reported and discussed their quarter on the call have indicated that festival demand, they are looking at is likely to be flattish while you are suggesting that you are experiencing a low single-digit growth during the festival season. What are you doing differently? Are you gaining retail market share or you are doing something different in the marketplace?

Niranjan Gupta: Let me hand this over to Mr. Sanjay Bhan to respond.

Sanjay Bhan: Yes. So, Kumar, I think the reason Niranjan mentioned about the kind of improvement in the sentiment overall, the key there is, this is clearly evident in terms of the footfalls. We have talked about earlier in the previous earnings call- we did talk about the lack of inquiries and not just the fact that there were lesser number of people walking in, but also the fact that even those who are walking in their conversion levels were abysmally low. Things seem to have come back, like Niranjan mentioned, in a very robust manner, therefore, leading to certain growth, which is, like you said, right now, not very high, but it is in lower single digits. But yes, growth nevertheless and given the momentum that we are seeing even after Dussehra there has not been any let up, it has been in fact building on. So, in contrary to, if I was to break the period, the first 10 days were more or less flattish, but the subsequent 10 to 12 days have been actually had a pretty decent growth rate. So overall, there is a belief that we will see some recovery going forward and hopefully we will report a positive growth in this period.

Rakesh Kumar: Great. Just to be clear, this low single-digit growth you are referring to is on the retail sales and not the footfall or booking?

Sanjay Bhan: They are retail sales; you are absolutely right.

Rakesh Kumar: I will fall back in the queue. Thank you.

Moderator: Thank you. The next question is from the line of Mitul Shah from Reliance Securities.

Mitul Shah: Congratulations on a very strong performance. Sir, you explained about this near-term phenomena of improvement in sales, but from medium-term point of view, next one-and-a-half years point of view, which are the indicators you generally look for the industry forecasting? That is my first question, and the second question is, in the past is there any strong correlation- with better monsoon have you observed, because at this time rainfall is around 10% excess, which had some negative impact in few geographies due to crop destruction, but it is positive for rabi crop as well? As for next year's point of view because even if there would be a monsoon deficit to the tune of 5% to 10% next year, this water reservoir will provide cover up those deficit, which also happened in FY2015 and 2018. So what is your take on this, sir being a rural player your judgment on next one, one-and-a-half-year point of view?

Sanjay Bhan: I think that is a very good question to ask under the circumstances, Mitul. Yes, there are lots of green shoots. This monsoon has been a mixed bag, in fact it started off a little inconsistent then it started peaking, and then it started pouring, I guess, and that is how it finally ended up. This year we had, virtually after about 100 years, a September as wet as this one. So there are positives clearly attached to it. There is also this a bit of a blemish in terms of crop destruction in certain markets, particularly cash crops, in the states like Madhya Pradesh where obviously soya bean has been hit badly, but there are obviously some very critical indicators that we watch out for and just to share that with you. One of the key indicators will be visible as early as mid or third week of November, which is when the rabi sowing starts. The current trend as it seems is, while the kharif sowing has been a little lower, yet at a yield level given the kind of crop prices given that the MSPs, etc., have been announced, there is a likelihood that at a farmer level there will be about 10% to 12% better yield despite a slightly lower production, which therefore will encourage farmers to go out and sow for rabi, which is a phenomena that finally will see a reversal because last year you know that we had a fantastic bountiful Kharif crop. But, it did not translate into moneys coming back to farmers in time resulting into a poor sowing in rabi, which was about 25% down, which resulted in the poor rabi yield in the month of April, May and then eventually leading to a further cyclical pit of another round of lower sowing for kharif, while it may have resulted in lesser production, but it will probably end up giving better yield. So the cycle will eventually break. Our sense therefore is that the first indications of a rural recovery would be visible by the third week of November, when the rabi crop sowing is in full swing. I think that will give us the right indication, but as it seems there is enough and more available in historic data that you can go back to and look at, that whenever there has been a bountiful monsoon it may not have an immediate impact from a kharif yield point of view as in the months of October, November, but it eventually has a very solid pushback or solid recovery in terms of the Q4 phenomena. So we do expect that this kind of rains will yield to a lot of positive sentiment and fortunately and thankfully a lot of this "over-rainfall" if I were to use that term has happened in markets which have been dry for long periods of time. I mean, think of Maharashtra, we have been hearing about episodes of farmer suicides, etc. In most areas, now we have bountiful rainfalls, the reservoirs are full and hopefully times are going to change in those markets. So we do expect a lot of positive sentiment coming into the rural area post November.

Mitul Shah: Sir, in terms of outlook, between motorcycle and scooter, do you expect now it will grow similar trend or again scooter will continue to reduce the overall pie?

Sanjay Bhan: Scooters, we have seen more or less, are not able to push beyond that 31%, 32% contribution and scooters is not as much a rural phenomenon as it is an urban phenomenon. So, unless the urban market starts expanding differently and the kind of coverage for scooters improves there, it is unlikely that scooters will see a recovery in terms of contribution changing significantly. But, what is going to happen is, the first-time buyers in rural markets, which is where the penetrations are much lower than in urban markets, penetrations in urban markets are being as high as they are. It is unlikely that scooters will see a major turnaround in terms of their contribution numbers going up, but it is quite evident that if rural market starts kicking as we just explained, if things improve and the sentiment in rural market improves, which we will know by end of November, then it is very likely that it will have a very positive bearing on motorcycle demand.

Mitul Shah: Thank you Sir. Thank you for the detailed explanation.

Moderator: Thank you. The next question is from the line of Ranjit Jaiswal from Bernstein.

Ranjit Jaiswal: My first question is on product pipeline. So what is your strategy especially related to EVs, which you plan to launch in-house?

Niranjan Gupta: So Ranjit, as far as EV is concerned, we have said this before. I think given that EV is an evolving space, we do not think that a single direction strategy is actually a right strategy. While some of the players have boasted about their singular direction strategy, but I think in any evolving space, if you look at history, it is important to have a multi-pronged strategy and while some would fire and some may not. As far as we are concerned, we have a strategy where we have invested in Ather. We are the largest shareholder in Ather, it is not a small stake and Ather has launched in Bengaluru, and now they have expanded to Chennai. There are a lot of learnings coming out of that, which are getting incorporated in our own program. Second thing is within HMCL, we already started building an EV. We now have a dedicated Emerging Mobility Business Unit, which has accelerated this. Third, we have opened up the Tech Center Germany where they are focusing on premium and EV only. So there is enough focus on this and we are navigating this space carefully, but surely and certainly.

Ranjit Jaiswal: Okay. And one more thing on the price hike related to BS-VI you mentioned 10% to 15% price hike, so can you quantify something related to the segment-wise price hike which could happen?

Niranjan Gupta: No, Ranjit. We would not be able to right now. But sufficient to say that there are enough indications in the market, that players seem to be passing on the full regulatory costs in the initial stage on the pricing and you would have already seen that with the models that have been launched. You know Hero policy, which is, we are always rational and sensible about pricing. Beyond that, I think you will see the first launch that we do very soon.

Ranjit Jaiswal: Thank you.

Moderator: Thank you. The next question is from the line of Pramod Amte from CGS-CIMB. Please go ahead.

Pramod Amte: Two questions. The first one is with regard to our employee expenses which used to hover below 5%, but in the current context of double-digit decline in volume and you are still growing your employee expenses by nearly 10% in the first half. How do you look at why it is rising even in this environment, one. Second, how do you look at with the VRS happening, what is the payback and can it come back below the 5% range?

Niranjan Gupta: Honestly, we have not been doing our employee expenses disproportionately. If you look at the overall increments and in general 2% to 3% headcount growth, which is required to ramp up our R&D center, etc, then on an absolute basis, if you look at, then the growth on H1-over-H1 on employee expenses is around 10%-10.5%, of that 8% to 9% would be increments itself and the balance is headcount growth. So I think, honestly, it is not about that, and the second thing is we do not want to get into a self-fulfilling prophecy of curtailing down our resources and thereby actually stalling growth. As we talked about in the beginning itself, what we see is signs of positive things, which are coming back. Overall recovery may still take a little bit of time, but we remain optimistic about the long term, given the entire opportunity that a country like India affords in the auto sector. So there is no reason for us to actually start shrinking our base. Probably, it is the time to build further capabilities. So I think on an absolute basis, it is not off. Yes, as a ratio, in the quarter, few quarters, where you would have probably lower volumes, as a ratio it will look increasing, but fundamentally it is not something that we worry about. We would rather use the capability to boost the topline than actually cut capability and reduce the topline further. So I think that is our strategy. As far as VRS is concerned, you have seen the exceptional item, which we have put in, we do not look at the payback, etc., on the VRS. This is more about that over a period of time you need to churn a bit of the employee base and which is what we have done, it was voluntary. So it is not done with the purpose of any payback and so I would not like to quantify on that aspect.

Pramod Amte: Sure. Second is with regard to scooter market. We have seen a substantial deterioration in your ranking and market share in the scooter space. Is it by design or you are forced to take this up and how do you plan to bounce back?

Sanjay Bhan: So, Pramod, I think the fact is that if you look at the scooter industry overall has not been doing too well as you would have figured out. The industry has been declining at a much more rapid rate than the overall industry trends, about 17% decline in scooters and within that we have been maintaining that the segment within scooters, which has had a disproportionate and a significant growth and relatively speaking, within the segment, 125cc scooters have done far better. In fact, even in the current environment, they are the only ones growing while as the 100 and 110s which are the mainstay, 76% of the market is from the 100, 110cc scooters, that has been declining at almost 23%. Now, obviously, 125cc is a new segment for us because, we have not been there earlier, we have just been there about 11 months now with Destini as the solitary option that we had. We have now strengthened that segment with Maestro Edge 125 and the FI variant. So now the portfolio is a little more complete. Clearly, that is a segment that we believe is going to lead the charge and growth for scooters and that is going to get internal evolution of the category into 125. No small wonder that when you saw the BS-VI scooter launched by one of our competitors, the first model they launched is a 125cc scooter. So it just goes to show the importance of that category. We had called it out last year. When we launched Destini, we talked about it (and since then) we have been able to maintain around a 15% market share in that category. Clearly, our aspiration is much higher. At an overall scooter level, the level of seriousness we have for the category is absolutely pretty much there and the fact that we have in the first six months, launched 3 new models of scooters, basically, strengthening the 125cc portfolio by launching 2 variants of Maestro 125, the FI and the carb variant and then also trying to bring in a refresh, a new product, the Pleasure 110 in the 100-110cc scooter category. Our portfolio is the 110cc needed a refresh, Pleasure has led that charge. Subsequently, as we go into the BS-VI zone, you will soon realize that all of our brands are going to see a massive change and hopefully that will bring in a lot of newness for the entire range and will help us come back in numbers. Surely, there have been some setbacks in the recent past, but our intention is to come back very strongly in scooters and a move to a position, which we ideally think we should own, which is a very strong contender in the category.

Pramod Amte: Thanks and all the best.

Moderator: Thank you. The next question is from the line for RaghuNandan from Emkay Global. Please go ahead.

Raghu Nandan: Congrats on the festive season sales. Sir I have two queries. First query was on RM cost. Gross margin has improved by almost 2%. What factors have led to this improvement? Also, if I look at H1, the change in inventory, which is part of RM cost was almost Rs.3.3 billion, but the balance sheet shows a change of Rs.1.5 billion, what is the difference there? My second query was on tax rate what is the expectation for the full year and H2 tax rates, Sir and lastly if you can also share the spare revenue?

Niranjan Gupta: Right. Many questions Raghu, but let me try and answer that. So one, as you yourself answered the change in gross margin is led by material costs, there are 3 parts to that and I would not quantify individual parts, but one is continuous savings that we get from our sourcing and LEAP program. The second is the general softness in the commodities, which is helping the auto sector and third of course is the inventorization, which some of you have already picked up, yes, which unwinds in the next quarter. As far as spares revenue is concerned, for this quarter, we have Rs.723 Crores of parts revenue, which is a growth of around 1.5% on a year-on-year basis. As far as tax rate is concerned, if you look at it, it has an impact because you spread it over three quarters, because Q1 was the higher or the full tax rate absorption and the benefit which came in Q2 also absorbs that. The way we have accounted is the overall full year tax minus the Q1, the benefit is spread over the three quarters. It talks about the benefit of the deferred tax liability, which get restated at the revised tax rate. So underlying, if you see from next year onwards, you should be seeing a 25% to 26% kind of tax rate, which is what comes if you look at the base rate, surcharge and cess. Hope that answers your question.

Raghu Nandan: That was very helpful and one more thing what I had asked was the change in inventory in first half was Rs.3.3 billion, but balance sheet inventory change was Rs.1.5 billion. I mean, just was trying to reconcile those numbers?

Niranjan Gupta: Maybe what you can do is you can take it offline with Umang who is able to answer this, but what the balance sheet reflects is the exact inventory that we have as on September 30, 2019 and valued at the appropriate basis.

Raghu Nandan: Thank you Sir. I will do that. Thank you so much.

Moderator: Thank you. The next question is from the line of Jay Kale from Elara Capital. Please go ahead.

Jay Kale: My first question is regarding the festive season and of course the inventory. I just wanted to get a sense that this you are talking of growth on Y-o-Y, festive-to-festive and what would be your inventory currently and what is the ideal level of inventory that you look at post-festive in a normal case scenario, if you could just throw some light on that?

Sanjay Bhan: Yes. So, Jay, thank you very much. Let me just answer this question on what is the normal inventory levels that we are very comfortable with, as much as the dealers are. So I think ideally the stock level that we are comfortable with is about 45 days. We maintain that. about 4 to 6 weeks of inventory is something that is required, given the kind of SKUs, the kind of network that we have, the penetration that we have. We need to keep the network well fed and therefore that kind of works out at about 45 days. Now while saying that it is important that we have a very good line of sight in terms of retail, which means essentially in a good, solid, healthy market situation, 45 days is the right level of inventory. However, when the market sentiment is poor, even a 45-day inventory starts hurting. Now to answer your question of what is our plan to close the festival season with, our intent is and we are targeting to get this down to 30 days. There is a reason why we are trying to get it down to 30 days, and we may be close to that, we may be thereabouts, but that is the intent and the reason is very simple. We are getting into, this is not a normal year, this is a year, which will obviously lead to a lot of change, it is a transition year of BS-VI therefore it will really put a lot of impetus on how we are able to manage our inventories and how we may be able to manage the transition best and to that extent we will need to be extremely careful and guarded about in terms of the kind of exposures we keep in the market. So while intention is to bring it down to 30 days, I would still retain that the ideal level would be 45 days. So we really have a headroom opportunity there, but the reason we are not counting that in, and we are sort of discounting that is only to bring in the seriousness about our intent to transition as smoothly as possible. So that is the whole idea. So ideal level, 45 days in a normal healthy market situation. In a rather not-so-healthy market situation, even the 45 days start hurting. The answer to your question on closure of festival, the target for us is about 30 days inventory.

Jay Kale: Great and this is including the sub-dealer level and 30 days you are assuming the last six, eight month's average sales based on that the 30 days calculation?

Niranjan Gupta: No our inventory levels are never including the sub-dealer level historically and all the numbers that we have said it is our direct dealers and that is how we monitor. Like-for-like, as long as all the other inventory levels are remaining the same it does not matter.

Jay Kale: Sure and just one, last on the scooter side, I mean, we built upon that, but just to understand, what are the macro factors, what should change in the economy for you to believe that scooterization will come back again say, in FY2021? You alluded on the rural factors which are more motorcycle linked, anything that you are looking at from the economy perspective that scooters would come back or do you think that once rural comes back, you will see scooters in the rural markets also coming back, which have been hurting currently or have rural scooters been grossly underperforming urban scooters currently?

Sanjay Bhan: Well, I will just leave you with one insight and I think I will leave it out for the jury to decide. Because right now there are multiple levels of assessments and guessings that are kind of going on, but there is one data point, which I would like to happily share with you is that if you look at the trend on scooterization and the sort of reversal or let us say at least a blunting of that scooterization you would possibly be able to plot it against a very healthy graph on the fuel price increase. Now if I was to take that data point as a fairly reasonable reference unless the crude drops down to $50 per barrel, I do not see any recovery beyond the point that it is already gone to, so I guess when you do the plotting and you do the graph, you realize that clearly, for consumers, fuel efficiency and mileage is a very critical one and therefore their belief that motorcycle will give a better mileage is not an unfounded one, that is also a reality. On an average, a motorcycle delivers 20% more fuel economy than a scooter. So as long as fuel becomes very critical in terms of the reason to buy for a consumer I think it will continue to be something that will haunt scooters. Unless scooters do something dramatic, which is bring the fuel efficiency levels as close to motorcycles, the possibility of reversing the opposite trend of scooterization is not going to change dramatically. So I guess our efforts with the BS-VI, people are talking about improvement in mileage, but those mileage numbers are still going to be way off from what motorcycles will deliver for similar technologies. So my guess, therefore, this is a level and for scooters to come back, they will have to outperform motorcycles in terms of what they deliver on mileage, etc, as one critical aspect, and there are several other areas which customers seek, but I am just leaving you with this insight and you can do the math on that. So therefore, we do believe that motorcycles will have a continued good run.

Jay Kale: Great. Thanks and all the best.

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

Jinesh Gandhi: Sir, my question pertains to your net realization, what kind of price increase you have taken in this quarter?

Niranjan Gupta: We took price increase in July itself, we have not taken from October 1, 2019, but in July what we took was around on a net realization basis, close to around Rs.200 per vehicle.

Jinesh Gandhi: Okay and what kind of commodity saving you would have benefited in this quarter? Most of your peers have been indicating about 20 to 40 basis points, is it similar for us?

Niranjan Gupta: It would be of a similar range and in that plus the LEAP program, which is the added benefit that we get.

Jinesh Gandhi: Okay and do we expect further commodity savings just because of the prices?

Niranjan Gupta: Honestly, it depends on where the commodities go from here. It is extremely difficult to forecast commodities, but if you look at the global economic growth projections of the IMF and the general forecast then there is no reason to believe that the commodities should do an about-turn. They are more likely to remain softish, but how soft and how far, very difficult to take a call.

Jinesh Gandhi: Sure and lastly, in terms of variable marketing spend, any sense on how they would have trended in 2Q versus 2Q last year, or versus first quarter?

Niranjan Gupta: What we are spending is a very similar level, so there is no big movement as far as our overall marketing and sales spends are concerned.

Jinesh Gandhi: Okay because we had about substantial increase and discounts at ground on two wheeler side, so that is probably what you would have budgeted for is it?

Niranjan Gupta: Yes. I mean, not as far as Q2 and H1 is concerned, you might see some elevated levels in Q3, which is the festive season, but again they are not million miles off from what we have been doing. We have not been doing "Mother of all discounts". We have been doing innovative schemes at 360-degree which is on financing, dealer, credit, and of course, some consumer-customer benefits as well because in festive in India, that is how the expectations are, but it is more sensible and reasonable levels that we are doing.

Sanjay Bhan: So Jinesh, just to add to what Niranjan was just saying, if you look at what we have been doing this festival A - I do not think it is way out of the league from what we have traditionally been doing in terms of the spend, but I am not going to talk about the spends. I am going to talk about more about what exactly we are trying to do. We are basically trying to look at all the potential levers of demand. Our focus is not on discounting or kind of giving massive sops to consumers, we are trying to make it a little more easier and more affordable to buy, by giving very, very interesting finance offers at very little documentation, hassle-free financing, helping them to exchange for those people who are either replacing their existing two wheelers, etc. So I think the enablement mechanism is working much harder for us and therefore it is delivering results. Like I said, at an overall level we are already in positive trajectory, which probably will get consolidated as we go towards the business end of the festival season, which is now the Dhanteras, Diwali and so on and therefore we will come back with some decent numbers again. The key therefore has been that most of the drivers and enablers of demand had been a little dormant over the last 6 months. So we realized it early on that if we have to really turn this around and we were hoping that there will be some intervention from the demand side from the government, but unfortunately, since that did not happen, we are sort of trying to trigger things on our own. I think one of the conscious decisions, and it was a very tempting one given the overall pressure on profitability and yet we took a prudent call of not changing our prices, given that the consumers were already under stress during the last 6 months and this particular quarter would have been even worse. So we thought of investing in those enabling systems and mechanisms that will trigger the next level of demand and we are seeing some impact coming in from that.

Jinesh Gandhi: Great. So any reason why our other expenses would have gone up on a Q-Q basis is it just impact of higher inventory, higher production or there is more to that?

Niranjan Gupta: Well, it is just the ratios are just impacted by the overall topline. Otherwise, if you look at an absolute basis, H1-to-H1, if you look at it, the other expenses on absolute basis are actually down by 8% and Q2 versus Q2, if you look at it, they are actually down by 10.5%.

Jinesh K. Gandhi: When looking on 2Q versus 1Q, there is increase, maybe it is...

Niranjan Gupta: I do not think that is the right way of looking at it. I think it is either you should look at Q2 versus Q2, or you should look at H1 versus H1. Otherwise there always is phasing involved based on the timing of launch programs, etc, etc. So one should not look at it sequentially, but to look at year-on-year, you can look at 6 months' basis even that actually shows an 8% decline.

Moderator: Thank you. The next question is from the line of Shyam Sundar Sriram from Sundaram Mutual Fund. Please go ahead.

Shyam Sundar Sriram: Just on the realization bit of course you did mention, even in the last call that you have taken a 1% price hike in July, but if you see on a quarter-on-quarter basis, the realization improvement has been much better. Has there been any support from other operating income in Q2 as compared to the Q1?

Niranjan Gupta: Not really, if you look at other operating income for Q2 is Rs.193 Crores and last year it was Rs.203 Crores in the same quarter and Q1, of course, was Rs.156 Crores. So maybe if you are looking at sequentially, then yes, that explains but year-on-year basis, our other operating revenues have by and large remained at similar levels.

Shyam Sundar Sriram: Okay, Sir. Okay. That is helpful, Sir and broadly you did talk about the promotion and ad spending, how would this compare with last year, are we seeing slightly higher level of promotion ad spending as compared to last year festive season?

Niranjan Gupta: I think we just answered. It is at a slightly elevated level as we said, but it is not something to be concerned about and like Sanjay, my colleague, explained, we are focusing on all the levers of growth and not just the discounting alone in the festive.

Shyam Sundar Sriram: Right. So on the financing penetration, you did mention that you are using yield financing as a lever to enable buying. Last quarter, we did talk about a 37% kind of financing for us how has it trended in Q2 and how are you seeing that in Q3?

Niranjan Gupta: Yes. So you are absolutely right. The focus on the financing has increased the financing levels to 46% in Q2.

Shyam Sundar Sriram: Okay, okay. 46% in Q2 and for the industry, also would have seen a similar improvement?

Niranjan Gupta: Difficult for us to say, as far as the industry is concerned. Maybe some other players are focusing on discounts, but we are focusing on financing as well and that has moved it to 46%.

Shyam Sundar Sriram: Okay. Sir if I may squeeze one last question. Sir, with BS-VI, will we be launching completely new platforms and wholly refreshed portfolio of products will that, in turn, sort of, in some sense, negate the cost impact that will come through?

Niranjan Gupta: You will get to hear from us very soon.

Shyam Sundar Sriram: Okay thank you.

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

Pramod Kumar: My first question is just a clarification on the answer you gave to Shyam prior to my question. How does this 46% financing penetration compare to last year same quarter, Sir?

Niranjan Gupta: 44% last year, same quarter.

Pramod Kumar: Because in the fourth quarter call, we mentioned a number 37% in financing so I was just a bit confused with the numbers.

Niranjan Gupta: 37% is Q1 that is the right number maybe you have got the quarters wrong and this quarter is 46% and same quarter last year was 44%.

Pramod Kumar: Okay. So it is a seasonal spike, which you are seeing in 2Q, which happens every year?

Niranjan Gupta: Not only seasonal spike, but also year-on-year improvement as a focus on financing.

Pramod Kumar: Sounds good Sir. and Sir I just wanted to clarify on the dealer receivable bit, how does the accounting for that work because we do see that our trade receivables have jumped another Rs.500 Crores- Rs.600 Crores over the balance sheet for FY2019. So I just wanted to understand a bit I believe you do charge interest component on the dealers for the outstanding payments where does that line item resides in the P&L and how much will be that number?

Niranjan Gupta: I would not quantify that number, but we do charge interest on over dues and that gets part into the other income.

Pramod Kumar: Other income that is below the EBITDA line, right?

Niranjan Gupta: Yes, other income below EBITDA line in the published results. It comes in the income line as b-item, which is other income.

Pramod Kumar: Other income. So it is not part of the operational numbers.

Niranjan Gupta: No. It is not part of our declared EBITDA numbers.

Pramod Kumar: No, because some of your peers do account it in the operational numbers, that is why.

Niranjan Gupta: We follow the absolute pristine accounting, which is that only operation thing we put in operations and the interest and financial items we put in other income.

Pramod Kumar: Great and final question on BS-VI transition, Sir and I believe we did not get the inventory number, actually, where it stands today. You talked about a 45-day target, but if you can help us understand where it is today and given the BS-VI transition plan as to by when do you see your kind of crossing a milestone of 50% production of BS-VI because some of your peers are looking at as early as January to be close to 70% to 100% range in terms of the monthly production for BS-VI. Where would you put Hero say in the month of say January or somewhere in terms of your BS-VI preparedness at the production level?

Niranjan Gupta: So let me answer your first question, which is the inventory. Current inventory, what we hold is actually wholly irrelevant. What we have is with our festive plan and we have given out also. What we are seeing and expecting is growth and with that, we should end up at 30 days that is what we are targeting at October end, which will be fantastic at that level or thereabout that level that we should end up with. Secondly, as BS-VI is concerned, we said that post-festive, you would see the launches coming one-by-one. We have a sequenced plan, which is calibrated, both from ramp-up perspective as well as launch perspective, and you will see us migrating over the period, starting post-festive until March.

Moderator: Thank you. We move to the next question that is from the line of Raunak Sarda from Systematix. Please go ahead.

Raunak Sarda: The first question is just a clarity on BS-VI transition. So how do we see once we start to model production in BS-VI would there still be scope of BS-IV vehicle production if there is demand because you highlighted that you are building in some estimates or expectations over pre-buy or that would be just based on inventory, which goes in Q3, and there will be no production overlap?

Niranjan Gupta: So we can do. I mean, because we have multiple lines and multiple manufacturing sites. Accordingly, we have various scenarios on which we are navigating to ensure that, A) we transition very smoothly between BS-IV and BS-VI and B) if there is any prebuying opportunity that comes our way, we are in a position to capitalize as well. It is a very fine line (we are) navigating, and we have scenarios, and our teams are there (working on these scenarios). There are teams that actually meet on a weekly basis. There is a steering committee, which meets on a fortnightly basis. There is a fair bit of work going on into that. I think our spread of manufacturing sites and multiple lines and scale, it gives us an added flexibility over other players to do this.

Raunak Sarda: I am assuming that would be pretty challenging. Then the second question would be, I mean, can you help us with how is the capacity utilization across different plants and how is the Halol ramp-up shaping, since the volumes have fallen so much in this year?

Niranjan Gupta: Yes, I think the capacity utilization across plants you can take it offline from Umang. You have seen our volume numbers and you know our capacities. So utilization is a function of that only. As far as Halol ramp-up is concerned, it is progressing well. It is except that, based on the volume, we allocate, depending on if it is a sale for Gujarat only because Halol has benefit. So all of that goes to Gujarat, all of Rajasthan sales go to Neemrana and the rest gets allocated based on where optimization makes sense.

Raunak Sarda: Okay. And the last question is for Mr. Bhan. If you can highlight how is the customer response for Maestro FI variant, which points out that the FI variant is as smooth as carburetor-based engine, any feedback from customer side?

Sanjay Bhan: Yes. So the initial feedback, frankly, Raunak, has been very positive. I think your question is how the customer is finding the FI technology on a scooter. So the answer to that is, as you know, Maestro FI was the first scooter with an FI to be launched. So to that extent it was novelty value clearly, and customers did feel the difference in the ride quality, etc, which gives us further confidence for our BS-VI because this is the setup to the BS-VI. Of course, BS-VI has got a few more things, but essentially FI and which gives us that much extra confidence because if you have played ride quality and the experience was pretty decent and the whole point is that this is clearly a very stable, good product and hopefully, it will continue in the same spirit as we get into BS-VI. That is a much better story for us.

Raunak Sarda: Thank you and all the very best.

Raunak Sarda: Okay thank you. The next question is from the line of Basudev Banerjee from Ambit Capital. Please go ahead.

Basudev Banerjee: Congrats for good set of numbers. I just wanted to understand that if I see your year-to-date wholesales are down somewhere around 17% and assuming things are going to be steady year-on-year in October but as you are saying that you are confident of prebuying during Q4 on a 30-day inventory, then what is your outlook for fiscal 2021 as it will be prebuying of the potential demand for fiscal 2021, so one year we are seeing almost more than double-digit decline so what is outlook on 2021?

Niranjan Gupta: So at this point of time, we would not be giving out an outlook on FY21. We have outlined various factors, both short-term and medium-term factors, and let us see how they play out and we will have to take on from there.

Basudev Banerjee: Sure and second thing, like what Pramod was asking on the call earlier, what was your inventory level on beginning of festive season, if you can highlight that will be great?

Niranjan Gupta: Honestly Basudev that is wholly irrelevant. What is relevant is that in festive you need to build up for sales because in the 30-days, us or anyone else, end up selling almost 2.5 to 3x the normal selling run rate and therefore the buildup we do based on that planning. All we are saying is that right now, the sales are at per plan and we hope to close at 30 days, which could be a little optimistic, but it is still be around those levels is what we hope. I think that is important. So wait out for a few more days.

Basudev Banerjee: Sure Sir. That is it Sir.

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

Hitesh Goel: Just wanted to understand this inventory when you are talking about, does this include the sub-dealer inventory also or this is only the main dealer inventory?

Niranjan Gupta: No, we have clarified, Hitesh, that it does not include sub-dealer inventory. In the past also it never included that. So these numbers are all like-for-like basis based on what we have been giving out in the past as well.

Sanjay Bhan: And just to cheer you up this inventory is for all ("Sab") dealers not sub-dealers.

Hitesh Goel: Okay and Sir, just wanted to get a sense, this BS-VI cost increase, have the company taken a call to fully pass it on or retains some of the cost increase?

Niranjan Gupta: So this is confidential information and therefore you will see in the models that come out in the market very soon.

Sanjay Bhan: What would you advise?

Hitesh Goel: I think given the demand scenario, you should not pass it down for me.

Sanjay Bhan: We will take it on record. So we will keep it there, but yes, it is a strategic decision and a call, the pricing is not a tactical thing. It would need to have a bearing on the overall play out that is there and like Niranjan mentioned, it is very sensitive information. Obviously, we need to watch the market very closely and accordingly plan our strategy.

Hitesh Goel: Great Sir and all the best.

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

Gunjan Prithyani: Just a follow-up on this inventory. You mentioned that by the end of the festive you expect that this should come down to 30 days odd. Is it fair to assume that, of course, retails are fairing maybe slightly positive, but you would be taking billing corrections in this quarter, so to that extent the wholesales could continue to stay negative?

Niranjan Gupta: Yes. To some extent, yes, you are absolutely right. The focus is on the retail and the focus is on market inventory. I think our job is to push retails and do the sales, applying all the levers that Sanjay has talked about, and thereby, get an inventory level from where the BS-IV, BS-VI transition can happen. Thereafter, of course, the more retails we push the more despatches or the wholesale also we can push.

Gunjan Prithyani: So this 30-day that you mentioned versus the typical 45-day healthy levels that you indicated earlier. My guess is you were saying 30 days right now because you are going through a BS-VI transition. So you may not aggressively introduce BS-VI inventory, and you would want to keep BS-IV lower in the market. Is that understanding correct?

Niranjan Gupta: Yes, because we have sufficient production capacities to actually take care of the upside or the pre-buying. So we want to calibrate. And like Sanjay mentioned, in time like these, it gives the dealer added headroom and headspace and liquidity space and from there on, then our BS-IV, BS-VI transition becomes smoother.

Sanjay Bhan: And intuitively speaking, Gunjan, would you rather have a lower stock of BS-IV to get your transition to BS-VI smoother or would you want to have high levels of stock of BS-IV and still manage to get to BS-VI in a very easy manner? I think the answer lies there. I think it is important that we understand the context in which we are trying to attempt to get to that 30-day inventory. It is to ease the system, de-stress the system and make sure that our transition to BS-VI is all set and then we will take calls, depending upon how the demand for BS-IV versus BS-VI. Like we said earlier, virtually every single model is absolutely ready for us to launch. The timing of those launches, the transition is part of our overall strategy. Unfortunately, at this stage and time, we do not want to really disclose that. That will be visible to you closer the time of the launch of various models.

Gunjan Prityani: Post festive is when the whole corrective action will be taken, and you will make sure that it comes down to 30-odd days?

Sanjay Bhan: No, during the festival, we need to do the stock correction. That is what we are trying to do. And post-festival, what will be visible to you is the platform that we have set for BS-VI transition.

Gunjan Prithyani: Okay, got it. And the second question I had was, are you seeing any divergent trends between the urban and the rural is as far as the last few weeks of pick up goes, has it been any way different for these segments?

Sanjay Bhan: Yes, to be very honest with you, I think the first 10 days, we saw a massive hit in terms of overall scooters not doing too well and scooters is a bit of an urban phenomena while as motorcycles, while it was not so strong initially, but it started picking up closer to Dussehra and thereabouts, and this trend continues. Even as we speak today, the trend is that scooters at an overall level, seem to be a little muted in terms of growth, but motorcycles are doing much better. If you were to link back to the overall show plotting of both these categories that you would figure out that scooters are by and large an urban-centric phenomena, therefore, urban markets are not doing that well because a lot of these initiatives that the government has taken, it is taking time to kind of play out. Therefore, demand side not much is happening and for the first-time buyers, motorcycle seems to be a bigger option for rural markets and, therefore, rural market has started doing a lot better. So you could say that in the first 20 days of this festival, urban is a little bit muted, while as rural has shown slightly better pulse.

Gunjan Prithyani: Okay and the last question on financing. Now this sharp increase versus last quarter is this a structural trend you think or was it more of festive scenario where you tend to have far higher festive schemes during this time so is it structurally moving up meaningfully on financing or it is just outcome of this quarter?

Sanjay Bhan: No, I think, Gunjan, there are 2 things. If your question is, was it done on purpose or it happened accidently then it will be clarified, I said this earlier, this was a deliberate attempt. We realized that one of the drivers of demand is the first-time buyer. We have talked about it earlier also and I would like to repeat that. The first-time buyer is the one who triggers the demand cycle and growth in the market. If the first-time buyers in any category stop coming to market the market is unlikely to grow. The overall impact to the market is defined by the first-time buying. Now one of the critical things for the first-time buyer is availability, ease and convenience of finance, at the same time, the cost of finance. So we try to apply as much judgment on that and try to put the entire impetus and focus on driving both the availability, the costs and the penetration of finance in a very different way. So the number that Niranjan has already shared with you, has an organic improvement, which normally happens during festival period, but there is also a very deliberate inorganic push to drive financing, particularly for those segments that are going to be coming to the category first time, hence, providing us the growth impetus.

Gunjan Prithyani: Got it. Thank you so much.

Moderator: Thank you. The next question is from the line of Joseph George from IIFL. Please go ahead.

Joseph George: My question was in relation to Niranjan's opening remarks. If I heard you right, you mentioned that the festive season has started seeing some growth, especially after the first 10 days of the festive season and you also mentioned that sustained recovery may take time. So I am not able to read the 2 comments together. So can you elaborate as to how exactly you are thinking about it?

Niranjan Gupta: Yes, the sustained recovery actually indicates that based on this festive can we say that now auto sector will be back on the growth path from November onward itself. I think it will be too premature to take a call on that. So that is why I said that sustained recovery may take a bit of time in terms of coming back to the growth levels that the auto sector, the 2-wheeler were seeing. The good thing is that, A), the festive is good, yes, relative to what was happening 6 months -- until six months before, which was 12% decline. On that scenario, if you see that festive over festive is actually whatever marginal positive growth is a very heartening sign and positive sign. Second thing is that, yes, there are a couple of tailwinds which we can see in the near term, but does it mean that now all is well and sector is back to its fullness of growth, the answer is no. So the sustained recovery may take time. That was the intent of making that statement. Equally, that we do remain confident about medium to long-term opportunity in the auto sector.

Joseph George: Niranjan, do you think there is some bunching up of demand that has happened in the festive season, now some of the sales have got postponed in the last 3 or 4 months, materialized or got converted into sales in the festive and similarly, because of the discounts or some of the schemes, some of the demand that would have come in, say, in November, December was preponed to festive and is that something that you are thinking about, a lot of bunching up of sales in the festive? Of course, it happens every year, but do you think it has happened a little more this year, which is the reason why I am not too confident on November, December, etc.?

Sanjay Bhan: So, Joseph, let me take that question. I think it is a very relevant question to ask. A, this is not unique this happens every year. People do tend to kind of bunch up their requirements towards the festival season. We as Indians love to do the binge shopping part during the festivals and I think that is not normal, but this year was a little bit peculiar in nature. So we saw a lot of uncertainty in terms of these cyclical trends and the fact that there was a lot of uncertainty around what is going to happen in terms of the regulation, in terms of the government intervention, there was expectation that the GST may be going down, etc, etc so a whole lot of people did postpone. In our July call, I think we mentioned at that time, one of the typical trends we were seeing in the industry at that point in time was the quality of inquiries was becoming poor, which is what I meant that the number of inquiries were going down, which is understood in a depressed market environment, but there still was the fact that the conversion of those inquiries was not happening. A lot of that was being deferred and we are seeing that the almost 24 days into the festival now. So the 24 days of the festival thus far and a lot of that has also converted into sales and therefore the question on bunching up is absolutely relevant, but most of that bunching is already fructified, some of that may still happen in the next few days because we are now, as I said, in the business side of, particularly the Northeast and Central India, this is the Festival, the big one. So hopefully, that will also show up and that is why we are very confident that the numbers will be even better than the numbers that are there currently for us.

Joseph George: Thank you.

Moderator: Ladies and gentlemen, that will be the last question. I now hand the conference over to Mr. Priya Ranjan for closing comments. Thank you and over to you.

Priya Ranjan: Thank you. Thanks for participating in the call and thanks to the Hero management for the opportunity to host. Thank you everyone.

Sanjay Bhan: Thank you so much Priya Ranjan. Thank you everyone. Happy Diwali.

Niranjan Gupta: Have a good festive. Happy Diwali everyone.

Moderator: Thank you very much. Ladies and gentlemen, on behalf of Antique Stock Broking, that concludes today's conference. Thank you all for joining us. You may now disconnect your lines.