



“Mahindra CIE Automotive Limited Q3 FY15 Earnings
Conference Call”

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Moderator

Ladies and Gentlemen, Good Day and Welcome to the Mahindra CIE Automotive Limited Q3 FY15 Earnings Conference Call hosted by ICICI Securities Limited. We have with us today from the management, Mr. Hemant Luthra – Chairman, Mr. K Ramaswami – Managing Director, Mr. Pedro — Executive Director, Mr. Sanjay Joglekar – CFO, and Mr. Vikas Sinha – Vice President, Strategy. 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 the duration of this conference is for one hour, and this conference is being recorded. I would now like to hand the conference over to Mr. Hemant Luthra. Thank you. And over to you sir.

Hemant Luthra

Good Afternoon, everybody, and it is my pleasure to welcome all of you on this call. It is an important call because this is the first time that we have shown what Mahindra CIE truly looks like including all of the entities under it. So we have published on the website the standalone results, the consolidated results. The company is now trading as one entity with approximately 325 million shares. It has been operating as one entity in any case by trying to leverage synergy. The degree with which we have been able to leverage the synergy is different in different verticals. In the Forging vertical, there is substantial progress, in Gears we are still working on it, but the results will be there for you to see shortly just they were in Germany. And all in all we seem to be quite pleased with what is going on. Mahindra is also very pleased with what is going on and CIE is pleased with what is going on, and therefore you have us at a time when the CIE team is here to talk about the strategy for growth in addition to whatever is being done to manage the costs while the volumes in India come back. So, we continue to look at managing costs in India when the volumes are relatively low, the Automotive sector and SIAM are saying that they have reason to be cautiously optimistic. We share them that view, and we also remember the time in 2009-2010 just after the ‘Lehman Crisis’ when everybody panicked and then demand came back very strongly. So we do not want to be caught flatfooted again. At this point of time there is no need for us to enhance capacity right now, because we are operating a few percentage points below capacity, maybe about 20% below capacity with a headroom there, so no CAPEX is required, but that does not mean that we should eschew any opportunities for growth which is what we are discussing internally today and tomorrow.

With that I will turn over the questions to the people on the call and we have got as I said KR who is the Managing Director; Sanjay who is the CFO; Vikas as the Strategy Head and Pedro who is helping us with the integration with Europe. So over to you and your questions.

Moderator

Thank you very much, sir. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. We have first question from the line in the line of Ronak Sarda from Axis Capital. Please go ahead.

Ronak Sarda

A couple of questions: firstly, if I do some back-of-the-envelope, the quarterly margins in the European operations which is now consolidated has seen sharp decline, so basically YTD

margins are 9.1% while the quarter margin at 7.8%. So if you can just highlight which is the pain point here and the outlook on the CV side in Europe now?

Hemant Luthra

This is Hemant Luthra and then I will ask my colleagues to pitch in. I think I alluded to this and saying that while the Forging operations which used to be of concern to you on this call turning around very nicely in Germany, the pain point at this point of time happens to be in Italy, where we have our Gear operations and that also with the help of CIE we are now feeling comfortable that the month by month improvement will start to happen. There may also be an element of the December holiday in there because of the quarter, and we are reasonably confident that even though the Italian business used to depend upon the army and defense and so on and that may have slowed down because of whatever companies are doing with their respective budgets. With the help of CIE we are redefining this business and saying that it should not necessarily be called Gears business, but it can do a Machining business. And if you go to a CIE website, I am not sure what they have there, but I do not want to jump in and disclose what is not there, I am just going to give you a qualitative, if we do what CIE does in their Machining business then you will see something significant improvement that is happening in the Gear business of Mahindra CIE because we are trying to transform that also into much more of a Machining business than a Gear business.

Ronak Sarda

Just to push this point further, I have taken the EBITDA before the one-time inventory loss at operations, even after that the pain point is largely the Italy business or the Mahindra Forgings Europe also has seen a sequential decline in margins if you can just give quantitative points on that?

Sanjay Joglekar

As Hemant explained, I think we cannot really go into so much of individual detail, but Mahindra Forgings Europe has been sequentially performing better and better. The issue is with Metalcastello and not so much operationally, but the volumes have been largely down and that is what has created this situation.

Ronak Sarda

Secondly, on the CVs outlook in Europe?

Hemant Luthra

I will just turn that over to Pedro, but before you finish this again with the one pain point that we have, if you remember, what we managed to do in the Forgings business was that instead of competing with CIE's large presses, we were able to go back to customers and reduce the pressure on us for year-on-year efficiency increases, we were able to get some price increases, we were able to sort out product mix, and much of that is happening in Italy. So my suggestion would be to just watch the space. Pedro, you want to talk about Europe?

Pedro Echegaray

Yeah, giving a forecast for Truck sales in Europe is probably the most difficult question at this moment. So it is really nobody can provide a forecast because the market gets up and down. What I can tell you is right now the market is better than four, five months ago when the Ukraine-Russia crisis has started, at that moment, really the sentiment was really negative, I would say that the sentiment today is neutral, but really we cannot provide any reliable forecast or projections, nobody can.

- Ronak Sarda** If you can just provide the consol gross debt and cash on books if you have numbers now post the merger?
- Sanjay Joglekar** I can talk about the net debt, as we have been indicating I think it is in the range of around Rs.1,500 crores at a consol basis.
- Moderator** Thank you. We have next question from the line of Raghu Nandan from Quant Capital. Please go ahead.
- Raghu Nandan** I had a question on the standalone business: So just to understand correctly, in the first nine months, the standalone business has seen a fall in EBITDA margin only because of negative operating leverage which should correct over the next two years given the expected improvement in the Auto sector. Second point I wanted to clarify was the PAT growth has been very strong, Slide #15, 74% growth has happened in the PAT in the quarter and for the nine months Slide #16 51% growth has happened in the standalone profits. So EBITDA growth is lower if you compare it. So what has led to this strong PAT growth – is it mainly due to improvement in Stamping business or is there any other reason?
- Sanjay Joglekar** Interest cost has certainly come down and that is one of the main reasons. Quarter-on-quarter we have been actually reducing the debt. That is the reason for that.
- Hemant Luthra:** I do not think it is just the stamping business, I think it is everywhere. KR can talk to you about what is happening in terms of operational improvements on the standalone business and castings and Forgings for sure. KR?
- K Ramaswami** Since you are talking about EBITDA margin being lower but PAT has grown strongly, obviously, it is related to the fixed expenditures and would relate to the interest cost, and there is a drop in interest cost which has strengthened the PAT.
- Raghu Nandan** Just a clarification here; does the standalone results also include the Gear business?
- Sanjay Joglekar** No, this is a legal consolidation, so Gears is a separate subsidiary, but Gears India is included in consolidated.
- Raghu Nandan** Sir, on the consolidated side, excellent margin improvements are there, but however the revenue was lower and when I look at specifically for the quarter, so, in this particular quarter European Heavy Truck sales actually was down about 22%. As far as I understand for the European business there is a very high dependence on the European Heavy Truck segment. So how has that impacted and also how much was the fall at Metalcastello?
- Hemant Luthra** I will turn it over, I am talking about a macro level. When you talk about consolidated once again we are talking to you about the elegance of this partnership. So Europe at the consolidated level include CIE Forgings and CIE Forgings caters to the Passenger Car market. So even if the truck market is not doing as well as we would like it to, the performance of CIE Forgings will caters to the Passenger Car market is holding up nicely. That is why we keep

talking about the synergy as to why it was such a great deal for everyone. And the same thing as I have mentioned, I do not want to repeat it with what we are going to do with Metalcastello and transforming it from a Gear business to a Machining business. I do not know if that helps you understand.

Vikas Sinha So we go back to your first question, Raghu, was how much has the decline in Heavy Trucks affected our MFE business?

Pedro Echegaray I would say most of the decline in the third quarter fiscal year has been because of the Christmas holidays in Europe. Europe it is a very seasonal month and traditionally December volumes tend to drop almost 50% because of Christmas season. So I would say that most of the decline is because of the holiday, and yeah, it is true the demand is not strong, but it is not significantly impacting our revenue in last quarter.

Vikas Sinha And the second question was how much was the fall in Metalcastello in revenues.

Sanjay Joglekar On the whole I think the European market has affected all the companies similarly and if you see in the overall revenue Metalcastello revenue itself is too small so has to affect significantly.

Hemant Luthra But let me again try and macro answer that question in addition. Metalcastello, I am not really concerned about the fall in the volume because what all the effort that we are doing just now is to weed out the unprofitable products, and therefore if there is some fall in volume and we are weeding out the unprofitable product so that we can focus on that or tell customers that you have to improve our margins. We are confident that with this process as focusing on the bottom line while the Italian economies and the defense deals are not coming through as strongly as they used to five years ago. The impact on the bottom line is what you should watch and not worry about the topline at Metalcastello.

Raghu Nandan On the margin trajectory ahead, like margins have been extremely strong for the nine-months at 9.4% on a consolidated basis, so how do you see the trajectory ahead, any outlook or guidance you can share for FY16 or '17?

Sanjay Joglekar I think Raghu, we know quarter-on-quarter you also attend calls, we do not really give guidance on margins.

Raghu Nandan No sir, how do you see yourself going ahead on the trajectory like CIE Forgings Europe has been a very profitable business with margins of 14-16%. So like we are slowly progressing towards those kinds of margins...

Sanjay Joglekar We have always said that MFEs in the past had always been 10%-11%, margins, and our first objective is to reach to that level. Going forward 14%-15%, we have to really see it, can be always kept as aspiration because the one group company is achieving, why not other but markets are different, one is heavy trucks, and the other is passenger car. So that is something we would not say that it is on our target at the moment, but achieving the pre-achieved levels of 10-11% is definitely our target.

- Hemant Luthra** I will add one more thing to that which is that if you watch Mahindra and Mahindra, during the days when Pawan Goenka was running the automotive business and Mr. Dawasia was running the tractor business, there is really nice healthy competition as to whether the tractor business will perform better than the automotive business or the automotive business would perform better than the tractor business. And subjecting ourselves to the same kind of competition and allowing our egos is going to be very helpful in saying if CIE can do X in Spain why should not be we able to do X plus something in India. Now, I do not know how long it will take, but that competitive juices are flowing inside the system.
- Raghu Nandan** That is very good to hear, sir. I hope you will also start comparing with Bharat Forge margins as well...
- Hemant Luthra** I am not sure whether I want to compare with Bharat Forge margins okay, because I think we are way and streets ahead is my impression of Bharat Forge margins in Europe.
- Moderator** Thank you. The next question is from the line of Priya Ranjan from PhillipCapital India Private Ltd. Please go ahead.
- Priya Ranjan** Given the currency depreciation in euro, do you see some kind of market share gain probably because the local production will be much more competitive in Europe now compared to what the other guys were exporting from India or to elsewhere geography?
- Pedro Echegaray** Automotive market decisions are usually long-term decisions and OEMs usually do not change in the sourcing of a specific part because of the changes in exchange rate. So I do not expect any significant variations neither positive nor negative because of that.
- Hemant Luthra** And also, Priya Ranjan, these are critical components that are going into the car and they are going to a truck, and people will not switch suppliers on the basis of daily movements and exchange rates, there could be a long-term trend if Euro is going to settle at 71, 72, then what should we do versus when the Euro was 80, what should we do, but on a day-to-day basis I do not think any purchase manager in any part of the world is doing that.
- Priya Ranjan** I am not talking about the daily movement, but if the euro settles at say around 70-71 then you can see some kind of competitive advantage vis-à-vis the exporters in Europe?
- Hemant Luthra** I suppose so.
- Pedro Echegaray** Yeah, definitely this is good for our European companies, this is definitely not bad, and I do not expect any significant impact on our P&L in 2015. As Hemant said if these exchange rates maintains in the long-term, yeah, there will be some positive results because they will be more competitive.
- Priya Ranjan** That was one of the precise reasons why the Metalcastello was also suffering because a lot of exports was happening, so, that has become a little bit non-competitive compared to the low cost countries ...

- Hemant Luthra** I want to stop you there, Priya, and correct you, Metalcastello's principle customers was Caterpillar in the US, Caterpillar's associate company Turner. Now if the US dollar appreciates against the Europe, that is actually good for Metalcastello. As long as we can get Caterpillar back and if Caterpillar is coming back on the basis the US economy is growing, it is actually positive for Metalcastello.
- Priya Ranjan** Just on after restructuring and everything, earlier I guessed the breakeven level for Metalcastello was roughly around €60-65 million, so where we are standing now or can we bring it down the cash breakeven level to around €50 odd million or something like that?
- Hemant Luthra** Cash breakeven should not be €65 million, it should be lower.
- Pedro Echegaray** Our plan is that with an existing demand level or with current revenue levels on Metalcastello around €50 million per year, Metalcastello should be a profitable. So basically, we are adjusting, we are cutting all our expenses, headcount, energy consumption, tooling consumption everything in order to make it profitable at the current revenue level.
- Vikas Sinha** As far as Metalcastello is concerned, there will be a certain time gap before the turnaround is complete. So please do bear that in mind.
- Priya Ranjan** Just coming back to India and Asia business, we have talked a lot in the past about the Southeast Asia, so when can we see some kind of action in Southeast Asia probably? And the second thing on India, when can we see some kind of additional market share or the product launches, etc., reflecting in the revenue and the profitability?
- Hemant Luthra** I will ask KR to talk about on domestic how the margin and volume are moving up, then I will make some comment upon Southeast Asia.
- K Ramaswami** The domestic market has not really picked up as you very well know, especially in the Automotive segment, and in the segment that we are supplying where our major customers are, our dependence is still both from Stampings and Forgings and to an extent Castings point of view is based on Mahindra & Mahindra, Tata Motors and Maruti, these are the major customers, there are of course other customers. Now, if you look at Mahindra & Mahindra or Tata Motors and look at quarter-on-quarter they have probably grown negative by about (-12% to 13%) We have already initiated action in two different ways — One, all the new launches for Tata Motors and Mahindra & Mahindra are introducing to sustain their growth level, they have already enrolled as a supplier. So we are protecting ourselves in possible growth of these customers. In addition to that, we have already started supplies to other customers as well, **like I** was telling last time we started supplying to Renault in India, we are in active discussion with several other customers, and we have a big development plant. In order to mitigate the possible problems that you may have in lack of growth, and we expect this to happen over because all this pertain to development of new products by customers and these have long gestation periods and we expect not only to protect ourselves in the existing customer base, also grow in new customer base and the outlook is fairly positive.

- Hemant Luthra** Let me address your question on Southeast Asia. I know that on the last call I told you that there is a wish list that if the markets have rewarded us for being sensible and not increasing capacity and doing an equity swap so that we do not unnecessarily increase capacity for Mahindra in Latin America and they do not increase capacity for CIE in Asia by doing this equity swap. I think I mentioned that on wish list was the ideal solution would be you would find a nice healthy sized Japanese component manufacturer who had a presence in Southeast Asia and who did not have a presence in Latin America or India, and therefore would use our plant to service its customers in India and Latin America, and we could use their plant to service our customers in Asia. Nothing happens in a quarter. All that I can say just now I do not think either CIE or the Mahindra team is known for letting grass grow under their feet. Otherwise CIE would not have made 50 acquisitions in 16 years, and as I said just watch the space. All other stock is binary, so I cannot tell you that in Q3 or Q4 of this year we will announce something, but no, I cannot, it is binary, let us see what happens.
- Priya Ranjan** Two points on the financials: Your interest cost is supposed to come down by around 3.5%. So is it already reflected in the financial or is it going to come from the fourth quarter onwards? And what should we take as a tax rate going forward?
- Sanjay Joglekar** Interest costs have already started coming down in the fourth quarter of the calendar year, third quarter of our FY15, it is October to December, but there will be more effects coming, particularly in the European companies going forward. Regarding tax rate, difficult for me to say.
- Priya Ranjan** Any kind of rough...?
- Sanjay Joglekar** Let us have our consolidated numbers and the complete year accounting done, then we will be able to comment on that.
- Moderator** Thank you. We have next question from the line of Jinesh Gandhi from Motilal Oswal Securities. Please go ahead.
- Jinesh Gandhi** My question pertains to MFE margins. Can you throw some light on how did MFE perform in this quarter vis-à-vis 2Q, I believe they had 7.5% margins, so how were they in this quarter? Second question pertains to debt. You have indicated you have seen QoQ reduction in debt. So if you can share what was net debt in second quarter?
- Sanjay Joglekar** There will be only normal repayments in the quarter, , and no specific debt reduction was done.
- Hemant Luthra** I think you will have to deduce it. I do not have the numbers on my fingertips but you will have to deduce it from the two statements that Sanjay has named, the debt was Rs.1500 crores, you know what EBITDA we are making, I have already told you that at this point of time everywhere in the world we have got sufficient headroom on capacity so the cash that is being

generated is being used for debt repayment and not so much for putting in new CAPEX which I do not need just now. If this does not answer your question feel free to...

Sanjay Joglekar Q2 to Q3 may be Rs.25 crores to Rs.30 crores would have reduced, not more. On MFE margins, that also I commented earlier, they have been performing at as we have been indicating around 8% or so.

Jinesh Gandhi Further Q-o-Q increase in this quarter as well?

Hemant Luthra That is right.

Moderator Thank you. We have next question from the line of Kunal Bhatia from Dalal & Broacha Stock Broking. Please go ahead.

Kunal Bhatia Just had one query in regards to you mentioned that about CIE is not only into Gears, but also into Machining business. Sir, currently, could you give us some sense what proportion of revenue comes from the Machining business and what is its scalability? Also what kind of improvement we could get in margins, I am not asking you for an exact number per se, but if you could just give us a sense where we are currently in terms of Machining as a percentage of revenues and where we are heading towards?

Pedro Echeagaray Being Machining a capital-intensive business, they tend to have a higher EBITDA margin, but we have already explained in previous calls, the main driver for our decision, it is return on capital, and for that the target that we have is minimum 20% return on capital which is also applicable for Machining.

Hemant Luthra Let me also correct one thing which I have heard in your question which may be a misconception. Gear business you can either produce Gears from the assets that you have got or you can use the same assets and do Machining but not necessarily finish up with Gears, you can do different components because those machines are universal machines. So when you ask me the question about what was Metalcastello doing and are they doing machine tools, no they are not doing machine tools. What we said was that they used to produce Gears for the Tractor business, for the Truck business, for the Military, for Caterpillar and everything else, but if the Gear demand is not there presently because of Defense business they will do Machining business for miscellaneous applications, and for those Pedro has already told you that the ROC is the true judge which is to keep it north of 20%.

Moderator Thank you. We have next question from the line of Nishant Vass from ICICI Securities. Please go ahead.

Nishant Vass I just wanted to say that we are talking from Metalcastello perspective, if I look at a consol number it is probably around 7.5% of revenue. So, considering that we have seen a lot of positives emanating from the rest to the business and the major hot spot. Do you think that you are fairly surprised at the pace of recovery in terms of your profitability, and you have been

highlighting that you are going to do various things on the Metalcastello front, so is the process of turnaround probably going to get accelerated from the earlier stated timeline

Hemant Luthra

Publicly I should never admit that I was surprised by the speed of recovery, I should say that I always plan for it, privately, of course, I can tell you that we were all hoping for these kind of recovery when we did the deal, we are happy that it is happening and it now sets a new benchmark for being able to do the same thing with Metalcastello. Why do you want me to say I am surprised with the recovery? I want to take credit, it is bonus time I want to be able to say that we plan for the recovery.

Pedro Echegaray

I would try to complement what Hemant described, typically in every restructuring in the first 12 months, you can deliver very good results by taking the low hanging fruits. In the case of MFE, one good example was the subsidy on the energy cost, which already by itself represented €4.5 million per year, but unfortunately that improvement rate can not be sustained. So, in the following months, definitely, we will continue working and improving the operations, but probably the improvement rate will be slow, and as already mentioned we maintain the target of reaching 10% to 11% EBITDA margin in two years from now in MFE.

Sanjay Joglekar

Faster recovery obviously in MFE that whether...

Nishant Vass

My second question is on the impact of translation of the euro because we see that there is obviously stated revenue consol basis is declining as you report in the presentation, can you give us a break up in terms of what is the euro revenue absolute growth or declined on the European business because I just want to take out the FX impact?

Sanjay Joglekar

There is no translation because as we have mentioned that we have done the translation at a convenient rate if you see Presentation Slides #15 and #16, it is done at the same exchange rate.

Moderator

Thank you. We have next question from the line of Srinath Krishnan from Sundaram Mutual Fund. Please go ahead.

Srinath Krishnan

Will it be possible to provide the current employee count of MFE, it was around 1,300 odd if I am not wrong year and a half back?

Pedro Echegaray

I do not have the exact number but rough numbers we have reduced by 200 the headcount in MFE since October 2013 till today.

Srinath Krishnan

Players like Scania in their call they have started speaking about improvement in European markets and they expect growth of about 5-10% for 2015. You have mentioned in your past also if the market declines, you will be able to achieve your targets for 2015, but at the same time if there is a recovery much sooner than anticipated, some of the guidances that you are giving for the next couple of years, do you think you will be able to achieve that by this year itself?

- Hemant Luthra** No, I do not think we should be talking to you any time about short-term guidance about how fast the recovery will happen. If one is Scania are saying it, we must thank them very much, let them translate that into orders, and as soon as they translate that orders to us, we will come back to you on a quarterly basis and say what the order book looks like, because also I think you should know that CIE maintains and we are learning from them a very healthy system by which says that how much of the forward capacity is booked with firm orders and how much do you have to get fill up that capacity. So we see optimistic signs but “Can we say that next year’s target will come into this one?” “No.” And since this other question was asked, I also need to tell you that in Metalcastello, just like 200 people have been reduced in Mahindra Forgings, the headcount reduction in Metalcastello I think is a little more than 50 to 55 people.
- Pedro Echegaray** Unfortunately, there is no consensus of the market about the forecast for 2015 market. You find in our presentation in the Slide #14, we are showing a statement from Daimler which is not us being optimistic as Scania, they think 2015 will remain weak.
- Moderator** Thank you. As there are no further questions from the participants, I would now like to hand the floor over to the management for their closing comments. Over to you, sir.
- Hemant Luthra** I do not have anything more shocking to say than except that we are very pleased with what is going on and what is coming.
- Moderator** Thank you very much, sir. Ladies and Gentlemen, on behalf of ICICI Securities Limited that concludes this conference call. Thank you for joining us and you may now disconnect your lines.