



“Mahindra CIE Automotive Limited (formerly known as Mahindra Forgings Limited) Q4 FY14 Earnings Conference Call”

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PARTICIPANTS

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Moderator: Ladies and gentlemen good day and welcome to the Mahindra CIE Automotives Q4 FY14 Earnings Conference Call hosted by ICICI Securities Limited. We have with us today Mr. Hemant Luthra – President Systech Sector; Mr. Sanjay Joglekar – EVP and CFO, Systech Sector; Mr. K Ramaswami – MD, Mahindra CIE Automotive Limited; Mr. E. Pedro – Representative from CIE; Mr. K. Jayaprakash – Chief Financial Officer; Mr. Burkard Rausch – CFO, Mahindra Forgings, Europe; Mr. Vikas Sinha – Head-Strategy, Systech Sector.

As a reminder, all participant lines will be in the listen-only mode. There will be an opportunity for you to ask questions, after the presentation concludes. Should you need assistance during the conference please signal an operator by pressing ‘*’ then ‘0’ on your touchtone telephone. Please note that this conference is being recorded. I now hand the conference over to Mr. Hemant Luthra. Thank you and over to you sir.

Hemant Luthra: Thank you. This is Hemant Luthra, good afternoon everybody and thanks you for being on the call. I have no idea how many people are in the call today but I do know that last time we had the call we had more than 80 people, thank you for your interest in the company. I think you will be well rewarded or have been well rewarded since you last were on the call. I recognize that there are some limitations of this call for regulatory reason, which is that all of you are looking at what Mahindra CIE will probably look in its ultimate form and what we can discuss today is only what are the results that have been put in the public domain regarding our forging operations in India, forging operations in Europe and I believe we have already put in the public domain the information regarding the performance of the composites company which the board meeting of which was also held yesterday. What we are trying to do in order to address your concerns and your interest is that we are trying to get the approval of the regulatory authorities that once the results of the MUSCO stamping business which is also going to be incorporated into Mahindra CIE and once the results of the Mahindra Hinoday business which is the casting business which is also going to be incorporated. If we can get regulatory approval to put out onto the website a proforma of what the consolidated company looks like, which is the Indian listed companies, the Indian unlisted companies and part of CIEs forging operations I think you will get a better picture of what this whole company looks like.

Meanwhile the only thing that I can say so to give you enough time to ask questions is that we are quite happy with the progress that has been made in Q4 particularly in Europe and we believe that the performance in Europe of Mahindra Forgings with the benefit of CIEs team that has come has been able to harness the synergies with respect to customers drive up the prices which some of the customers prevent us from having to go outside to third parties by moving product from one Mahindra’s forging location to a CIE location because

they are now all part of Mahindra CIE has ensured that we have had a good quarter in Europe and that is sustainable and I think I will leave it to you to ask question because I can only give the confidence that we think things will continue.

And also I do not know whether you have seen the press release which we have given some flavor of what is happening yes there has been a slowdown in India which has affected our forging business topline but KR and team has done a brilliant job of controlling costs we cannot yet talk about the casting business which has been unlisted, the results are not in the public domain but as I said we are trying to consolidate everything and put it on the public domain with the regulator's approval. The casting business has benefited from the fact that the tractor business is doing well, exports are doing well, in Europe the demand that has slowed down is starting to pick up again and we think that what has happened in the fourth quarter can continue going forward. So on that note still very positive, still very bullish about what is happening here, still very confident about benefit of this alliance and over to you for questions.

Moderator: Thank you very much Sir. Ladies and Gentlemen we will now begin the question and answer session. Our first question is from Srinath Krishnan of Sundaram Mutual Fund. Please go ahead.

Srinath Krishnan: Thanks for the opportunity sir. I wanted to understand this transformation of margins to about 6% in the European entity, for the first nine months it was only about 1% margin that you had done, so how has this really come sir, is it more from the pricing front or is it from the cost optimization measure, this is in context with Schoeneweiss gross RM to sale of gross margin decline that has been happening for last two three years. Is the negotiation bearing any fruit that you are able to revise in the last six to eight months any price revisions that we have been able to see from the customers?

Hemant Luthra: I am happy to turn this over to Burkard and if you still have a follow up question on Burkard who is the CFO there in Mahindra Forging we will supplement it.

Burkard Rausch: In fact it is a combination of several different points. As you mentioned already it is an increase in pricing with some customers and some specific products but in combination to that especially at Schoeneweiss it is an increase in productivity and due to the experience and the technical competence of our CIE colleagues where we have established a number of very specific projects to increase productivity and we see the fruit of this increase and let me just give you one significant example, during the last calls in the last two, three, four years we always discussed the importance of the big press the 12800 tonne press standing here at Schoeneweiss this is the biggest one in the whole forging group and in the past we

produced something between 15000, 16000, 17000 parts per month and just to give you the comparison in the first quarter of this year we had an average of more than 21000 parts in the first quarter which means that productivity and the output of this press which generates more than 60% of the importance of the sales of Schoeneweiss and this increase of more than 30% of output from this press is significant step forward, and this is not just a switch from changing one little thing to make it from black to white, it is a number of specific projects reducing the time to change dyes, improving the uptime, reducing maintenance times and things like that which in consequence leads to this significant jump and having those project established right now. It is very promising that this process will stabilize and even will improve for the future now there is a significant example for this positive improvement.

Srinath Krishnan: Sir since you are speaking about 12800 tonne press sometime back it was mentioned that this is an highly automated press of yours and that last annual report says you have about 398 employees in total both white and blue color, so just wanted to understand since employee reduction is a big plan of yours in turning this company around so how much is it possible from this 400 count, with this 12800 contributed nearly 60% of your sales how much and being automated what is the possible reduction in employee count here.

Burkard Rausch: When we look to the average of personal cost we have seen personal cost in the German entities especially of something about 30% in the past and we are reducing it step by step and there are additional activities going on to outsource activities where we see that external services can be bought significantly cheaper and in addition there are a number of projects about automation where our Spanish colleagues have got significant experience coming from automotive production but this will take some time and in the next months we will see that the personal costs which average in euro in Q4 already was below 30% will come down furthermore.

Srinath Krishnan: Okay average cost per employee I think will come down further it is turned about 30% already, am I right?

Hemant Luthra: It is not average cost per employee, it is the total cost of employees as a parentage of sales, it was 30, it has come down, our long-term goal was 20 which is consistent with what CIE achieved so the idea is going to be to get to the best in class.

Sanjay Joglekar: Sanjay here, let me clarify a few things, yes head count reduction will be considered but please keep it in mind that MFE has around 175 to 200 temporary people and one can address it in a proper way without incurring much costs. There are people who are close to retirement, appropriate settlements can be made and again having younger people in their

place so as productivity goes up at a lower cost and third when we talk about personnel cost it is not the result of only out of reduction of people, it is also resulting because the productivity is up and maintenance downtime is low, the overtime has come down, working on holidays is also coming down, that is something which is very costly in Germany, that is also contributing.

Hemant Luthra: And lastly since I know that everybody has this question about Europe the work started on this on October, because before that the competition commission did not allow people from CIE to enter. So really what you are saying is the benefit of just the first six months of effort. We think there is better to come.

Sanjay Joglekar: And just to clarify I think Hemant you mentioned 20% which we were thinking about but probably at present we would not put it as a target or something in the near future it is going to, if at all it is going to take a very long time.

Srinath Krishnan: Yes, from 30% of sales this may be a long-term target distributing it down it 20% or so.

Sanjay Joglekar: May be target I would put it not 20% could be maybe around 4% - 5% point lower than the current cost.

Srinath Krishnan: Sir again a long-term some sort of a guidance just to improve last year EBITDA margin from 2, 2.5% from the European entity to about 10% now you are already at 6% so it is something in the automotive industry like newer models command higher pricing over a period of time please correct me this reduction in pricing which happens so in this maybe a long term how generally is the mix, are you building any sort of mix improvement that this will also be helpful in improving your margins or is it primarily on the cost front that you are looking at this expansion?

E. Pedro: Good afternoon. It is not a target. It is a reference CIE forging plants have 14% EBITDA margin. We have another important reference which is the fact that MFE our forgings in Germany, in Europe, already had around 11% EBITDA margin at peak in 2010, so everything considered and taking into account the positive trend that we have already experienced in so short a period of time we think that in the long-term we should be able at least to go back to those 11% or 12% EBITDA margin that we already have in the past.

Moderator: Thank you. Our next question is from Srinivas Rao of Deutsche Bank. Please go ahead.

Srinivas Rao: Sir thank you very much I just wanted to first check on the structure of the company I understand that CIE made an open offer for its subsidiary in Brazil so that there will be one



listed company in Spain what is going to be the listing structure for the Mahindra CIE entity?

Hemant Luthra:

I do not think there is any difference, what I can say as a member of the CIE board is that they looked at Brazil, CIE had a more optimistic view of Brazil than the rest of the analysts community did, they saw that the price of Brazil was under valued and in Euro terms it was about the same as what they had the IPO at whereas in Brazil in real terms the price offered was at a 25% premium. In the interest of good governance CIE offered the people from Brazil part cash and part option to convert it into the stock of CIE parent but if your question is leading to is the same thing going to happen in India that has not been discussed it has not been on the cards and we believe that there is advantage in having a listed company one to address the Indian, Asian, South East Asian market and the other one in Spain, there has been no discussion about changing the structure.

Sanjay Joglekar:

We wanted a footstep in the emerging market and India is the best so the situation is very different here, we are not really anticipating any such steps for the Indian company.

E. Pedro:

What has happened it has changed the fortunes in CIE from South America basically Brazil to India in Asia so that is one of the reasons why CIE decided to list Autometal in Brazil but continues with a plan to keep in Mahindra CIE as listed company in India.

Srinivas Rao:

Understood sir, this is very helpful. If I can just ask a follow up. What is the broad likely shareholding structure of the India listed company, which we are anticipating?

Hemant Luthra:

It is very simple it has been made public. Sanjay you want to take it?

Sanjay Joglekar:

The number of shares post merger subject to approvals going thorough will be around 325 million number of shares.

Hemant Luthra:

Of which CIE will have 51%, Mahindra will have 20% and thereabouts and the listed shares are still of the order of 28% / 29% what we are particularly pleased about is that instead of the small volume that we saw in the past 60000, 70000 shares being traded we are seeing 2 million shares being traded, delivery is high, people are seeing that there is a float and are taking their calls about what to see as a future of the company and I do not know whether that answers your question what more you want.

Srinivas Rao:

No this is helpful I just wanted to double check all the share swaps have been completed or there are still...

- Sanjay Joglekar:** No, let me say I think probably you are not updated in this regard.
- Srinivas Rao:** Pardon my ignorance but when I speak to investors while you have put out in public domain and I must appreciate that just wanted to get an updated view from you.
- Sanjay Joglekar:** No, problem. So after the open offer we were supposed to make application to the high court for merger that has been done. Now after the hearing the process will start if required and calling meetings of share holders and swaps will be completed post merger and a tentative date which we think just now is somewhere around middle of September.
- Srinivas Rao:** Okay understood.
- Hemant Luthra:** Now we are trying to fix the date when the shareholder meeting takes place for approval of merger.
- Srinivas Rao:** Fair enough sir this is helpful thank you so much.
- Moderator:** Thank you. Our next question is from Raghu Nandan of Asian Markets Securities. Please go ahead.
- Raghu Nandan:** Thank you for the opportunity sir and congratulations on a very good set of numbers especially in your European operations. I had a few questions firstly can you throw some light on the quantum of price increase, which was taken at the European operation sir?
- Sanjay Joglekar:** No I cannot, it is difficult, we cannot even quantify like that and it was done I think for certain customers and not certain products and not for all.
- Raghu Nandan:** Sir basically when I take the FY'14 results on a consolidated basis and the standalone results on a consolidated basis and deduct both of them to get implied P&L for the subsidiaries I see that there has been a reduction in the raw material cost and the employee cost of course like it is a full year number I am talking about so I just wanted to understand the improvement which came in the fourth quarter where was it sir, was it in RM cost, was it in employee cost or other SG&A expenses?
- Sanjay Joglekar:** You are talking about Germany right. There has been a reduction on two, three account that one is basically the material cost resulting due to some price negotiations and also due to some improvements in the method of producing things like reduction in wastage, reduction in scrap and such things. Other is that we have been talking about is the energy subsidy. If you remember we briefed on the last call.

- Raghu Nandan:** Yes 400, 000 Euro per month.
- Sanjay Joglekar:** Approximately 4.5 – 5 million Euros a year that has started from January so that has been also factored in Q4.
- Hemant Luthra:** The other thing that has happened which I do not know how to put my arms around it in terms of numbers is that supposing Mahindra Forgings is a supplier to a principal OEM and the principal OEM has said that you give us a year-on-year reduction. Then the OEM says that I am sorry you have to deliver regardless of the fact that I was supposed to give you X volume at Y price but I am not giving you X volume but the year-to-year reduction you still were to give me. The ability for CIE and Mahindra Forging Europe to combine their marketing forces in a manner that is able to pressurize the customer and say that we are suppliers of this part we do this basket of parts and if you guys do not want this basket of parts from us then we will take action and we will get some other customers, so the ability to put some pressure on customers has helped. The synergy of marketing has helped, the cost reduction has helped.
- Burkard Rausch:** There is a third aspect that from beginning of this year it is a switch from Euro V part to Euro VI parts and the Euro V part price wise and at the end of the lifetime cycle and the Euro VI parts at the beginning of the lifetime cycle from this aspect the product mix has been positively influenced.
- Raghu Nandan:** So if I understand correctly the Euro six part would be higher in value and if I remember correctly it would be a content per vehicle addition of at least 20% so should I assume they would be having slightly better margins than the Euro five parts.
- Burkard Rausch:** Absolutely.
- Raghu Nandan:** Sir, the employee cost reduction plans you had about if correct me if I am wrong that close to like a part of the employee base was supposed to be reduced so has that already played out or would it play out in this fiscal year FY'15.
- Burkard Rausch:** It started already with some specific projects but that is something, which is going on step-by-step, machine-by-machine, project-by-project, so we see already the first fruits but there will be continuously more effects coming in the next month.
- Moderator:** Thank you. Our next question is from Nishant Vaas of ICICI Securities. Please go ahead.

Nishant Vaas: The quarter-on-quarter performance for the Indian entity has been really good so what is driving this quarter-on-quarter increase and second of all for next year when your clients, their model launches are specifically going to happen what do you think that EBITDA performance can rise to, generally ballpark sense not a number but a ballpark sense.

Hemant Luthra: I am just going to turn this question over to KR. He is the one responsible for making things happen in the India plant and let me see if he is willing to stick his neck out for what his next year's numbers are going to be?

K. Ramaswami: The last quarter's performance was very good as you mentioned but I would say the indication should be based on the whole year's performance because fluctuations in customer requirements take place during various quarters. As far as next year is concerned or the current financial year is concerned we expect to reach fair amount of growth because the indications that we get from the market although they are fair early appears to be very positive and we should look at numbers slightly better than the EBITDA numbers that we have been getting in the last year as opposed to the quarter, because quarter-to-quarter comparison becomes a little bit ambiguous because there are several variations it could be due to monsoon, it could be due to elections, it could be due to anything depending on that the customer production varies.

Nishant Vaas: Sir if I were to state it in a different manner if the utilizations for the annual basis were to remain similar to say Q4 so we could do a similar EBITDA at least in next year.

K Ramaswami: Yes, I think that is a reasonable assumption.

Nishant Vaas: Okay thanks a lot, my second question is on the European entity now this is more towards the CIE management typically since you taken over in terms of employees obviously we have been talking about employee reduction I want to get a sense on the fact that how has the German entity or the German employees taken to you and has it been harmonious what is the kind of degree of resistance that you have seen towards change because we all know the problems that were highlighted, how easy or difficult is it to kind of bring that change into the system?

Hemant Luthra: Since I have the luxury of sitting a little bit distant away let me try and do that and then I will be happy to have Burkard respond to it. Yes there were concerns everywhere. Mahindra is a very transparent open organization, they were concerns as to how things would work, but one of the things that I am going to say is that nothing succeeds like success, so if there was a fear that there would be a whole scale firing of people, it has not happened, if there was a fear that how integration will happen despite my saying to them

that this is not an auction process that got CIE and Mahindra together it is an identity of views, it is a chemistry between the promoters of Mahindra Forgings and that of Mahindra CIE I think all of that has started to play out but the biggest thing in terms of morale and Burkard can correct me if I am wrong is that when you see Schoeneweiss starting to improving results instead of seeing negative EBITDA you suddenly see that fourth quarter is fantastic, morale goes up productivity goes up and I think that German colleagues are responding in the most mature manner to saying I heard Burkard use the expression voluntarily a few days ago that the kind of support that they have got from CIE is “brilliant.” I will leave it to Burkard as a German resident there to respond.

Burkard Rausch: Let me answer your question from the German point of view and let me start in the past and after some years of difficulties, technical difficulties, breakdowns, market difficulties all the things we discussed over the last years, the expectation of the employees was that changes have to happen if the company wants to survive and all companies within the group want to survive for the future and to be strong and healthy for the future. So that was a basic expectation that changes have to happen and of course you are right when a new shareholder steps in there is a certain doubt, question, fear whatever you call it, what will happen but as we mentioned before we have got a high percentage of temporary employees, hired employees so doing those changes in a professional transparent way and using the contract workers as a buffer as we always explained it in the past as well to say yes we do this and that and that project and this brings a reduction specifically at their place but we have got alternatives enough to offer other jobs within the plant you have to be prepared to do another job that is what we expect from you but we offer you another chance and people seeing that we handled this process professionally on one side from the technical point of view but fair and transparent with the unions, with the people in a fair manner brings a confidence that this is the win-win situation.

Moderator: Thank you our next question is from Nikhil Deshpande of Sharekhan. Please go ahead.

Nikhil Deshpande: Sir I just wanted to know what is the capacity utilization in the Indian operations as well as the European operations.

K. Ramaswami: Yes we can, from the Indian perspective we can do about 10% to 15% sales more than what we are doing and if you stretch it probably 20% more than what we are doing with the existing capacity.

Nikhil Deshpande: Sir and the European operations?

- Hemant Luthra:** Europe I think the answer has been given before which was that the same plant produced 100 million a quarter, last quarter I think we have running at between 70 to 75 million so there is headroom there and with all the productivity increases kicked in after October and now I do not think we are looking at capex if that is where your question is leading to.
- Moderator:** Thank you. We will take our next question from Raghu Nandan of Asian Markets Securities. Please go ahead.
- Raghu Nandan:** Thanks again sir for the opportunity. Sir can you please share the sales volume number for FY'14 for standalone and the subsidiary. The numbers, which I had for last year, was around 33000 metric tonne and about 120000 metric tonne for India and Europe.
- K. Ramaswami:** If you look at the sales tonnage in FY'14 it is around 28000 tonnes.
- Raghu Nandan:** That would be for the standalone business.
- K Ramaswami:** Yes.
- Raghu Nandan:** And for the European business sir?
- E. Pedro:** It is somewhere around 125000 tonnes for the European entity.
- Raghu Nandan:** So that means that the realization improvement given the currency movement that would have contributed close to 15% to 16% growth in realization would that be correct?
- Sanjay Joglekar:** What you have to see for the European entities sales have been converted from Euro to Rupee at a rate of about 81 rupees, whereas last year the conversion was at a rate of about 70 rupees and in our press release, in fact we have given what is the impact of this which has been given in the press release.
- Raghu Nandan:** That is about 16% odd sir.
- Sanjay Joglekar:** Around Rs 293 Crores. So if you value the sales at Rs 70 per Euro instead of Rs 81 per Euro, the sales would be lower by Rs 293 Crores and the rest will be taken at the absolute increase either in terms of volume or price.
- Hemant Luthra:** But in terms of Euro millions, it is in what, what is the number in Euro million?
- Sanjay Joglekar:** It is from Euro 260 million to Euro 278 million.

Raghu Nandan: That has been given in the press release sir 278 million and sir like just on one of the questions which was asked earlier that among the entities in Europe which entity was the biggest contributor for this improvement in margin sir, was it Schoeneweiss as was discussed.

Burkard Rausch: As Schoeneweiss had got the biggest difficulties in the past the improvement is the strongest in Schoeneweiss

Raghu Nandan: Sir, two more queries from my side, how do you see the general outlook for the Europe business, I understand if you cannot share numbers, qualitatively if you can take me as to what are your thoughts on the business and lastly like Hemant sir was initially talking about a proforma, if at all it is being published by when can we expect that sir?

Sanjay Joglekar: We will look at it and we will try and put it by end of the month.

Hemant Luthra: In any case it cannot be done before May 21.

Burkard Rausch: Coming to your market question when you look to the press releases and the published announcements from our main customers whether it is Daimler, MAN, Scania, and Volvo, all of them expect a flat market. So our expectation is that market volumes will remain more or less on the same level.

Raghu Nandan: Okay and just one request I had from my side sir basically like when you share in the proforma numbers just requesting you to share some numbers on the CIE Forging which is the Spain and Lithuania plant because like even certain basic numbers like network and gross block we do not have access to those numbers. Apart from that I wanted to congratulate.

Sanjay Joglekar: CIE forging that in the CY'13 results have been announced is not it.

Raghu Nandan: For Spain and Lithuania sir?

Sanjay Joglekar: That is separately not given. I think this kind of discussion cannot go on this call.

Raghu Nandan: Thank you very much and once again congratulations to the Europe team for achieving such a good performance sir.

Moderator: Thank you. As there are no further questions from the participants, I would now like to hand the floor back to the management for closing comments.



Hemant Luthra:

Okay so thank you for all of you for taking this time off to be with us I know you are pleasantly surprised and happy with the European performance I think when you see this results you will also see the benefits of what has happened in India what you have not yet seen and I cannot forecast numbers is that as the CIE management stepped into the place in Europe we had costing systems that were being harmonized once the costing systems are being harmonized we started to look at what product should be moved from Germany to Spain from Spain to Germany from Germany to India, from Spain to India and once all of that has happened I think you would see some additional benefits of the synergy of what this whole alliance is about. I am not going to quantify the numbers but that is what the alliance was about, CIE has told us that, Pedro, you just heard him say that they want to use India as a launch pad for India and for South East Asia we are working on that direction, synergies between Europe and all of the European operations are being harnessed and anything that you people asked about Latin America I do not think you should read into it an extrapolate in to that, something similar is going to happen in India.

Moderator:

Thank you very much. Ladies and gentlemen on behalf of ICICI Securities Limited, that concludes this conference. Thank you for joining us and you may now disconnect your lines.